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"The Government at the Mercy of Its Contractors": How the New Deal Lawyers Reshaped the Common Law to Challenge the Defense Industry in World War II

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“The Government at the Mercy of Its
Contractors”: How the New Deal Lawyers
Reshaped the Common Law To Challenge the
Defense Industry in World War II

NICHOLAS PARRILLO*

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INTRODUCTION

The New Deal marked the consolidation of a novel and, in some ways, enduring set of interrelations among courts, legislatures, and progressive politics. At the intellectual level, it saw the ascendance of two ideas. First, the market was not free, natural, or neutral, but instead entailed coercion and political contingency.¹ Second, judicial decisions were not determined by scientific principles but instead required policy choices, meaning that the judge's function had a legislative aspect, even though the judge lacked the legislator's accountability to the people.² In light of these ideas, the common law baselines of the market no longer deserved special reverence.³ At the institutional level, the New Deal embodied the triumph of an electoral coalition that demanded a systematic alteration of economic outcomes across society—something that only legislatures and administrative agencies could provide. In light of all these changes, courts needed to stand aside and allow legislatures

1. See generally BARBARA H. FRIED, *THE PROGRESSIVE ASSAULT ON LAISSEZ-FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT* (1998); HOWARD GILLMAN, *THE CONSTITUTION BESIEGED: THE RISE AND DEMISE OF LOCHNER ERA POLICE POWERS JURISPRUDENCE* 147-93 (1993); MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW, 1870-1960: THE CRISIS OF LEGAL ORTHODOXY* 33-63, 145-67, 194-98 (1992); CASS R. SUNSTEIN, *THE PARTIAL CONSTITUTION* 40-42, 45-62 (1993); CASS R. SUNSTEIN, *THE SECOND BILL OF RIGHTS: FDR'S UNFINISHED REVOLUTION AND WHY WE NEED IT MORE THAN EVER* 17-34 (2004).

2. See generally G. EDWARD WHITE, *THE CONSTITUTION AND THE NEW DEAL* 167-236 (2000) (covering the common law and constitutional law). For additional background on the increasing recognition of judicial policymaking in the early twentieth century, see generally NEIL DUXBURY, *PATTERNS OF AMERICAN JURISPRUDENCE* 9-159 (1995); Thomas C. Grey, *Langdell's Orthodoxy*, 45 U. PITT. L. REV. 1, 39-50 (1983); Thomas C. Grey, *Modern American Legal Thought*, 106 YALE L.J. 493, 497-502 (1996) (reviewing DUXBURY, *supra*).

3. See SUNSTEIN, *THE PARTIAL CONSTITUTION*, *supra* note 1, at 40-42, 45-62.

and agencies to take the lead in governing, at least in economic matters.⁴ The New Deal was the nation's most decisive leap into the "Age of Statutes," inseparable from the welfare state.⁵

The federal courts, in particular, were subject to new restraints. In constitutional review of economic legislation, the Supreme Court abdicated its roles as guardian against "class legislation" and as enforcer of states' rights.⁶ Demonstrating how much narrower the possibility of neutral and principled judging had come to seem, Justice Robert H. Jackson declared that the boundaries of congressional power to regulate interstate commerce were "not a matter of legal principle, but of personal opinion; not one of constitutional law, but one of economic policy."⁷ And whereas the federal courts had once asserted the right to engage in their own independent "search" for the common law in cases of diversity jurisdiction, the Supreme Court now abolished that practice in *Erie Railroad v. Tompkins*.⁸ The result was cheered by many New Dealers.⁹ It fit nicely with their positivist understanding of law.¹⁰ That is, the "search" for the common law was really policymaking in disguise, and policymaking was better left to actors more democratically accountable than the federal courts.¹¹

4. HORWITZ, *supra* note 1, at 213–30 (analyzing the New Deal battle over administrative power); EDWARD A. PURCELL, JR., BRANDEIS AND THE PROGRESSIVE CONSTITUTION: *ERIE*, THE JUDICIAL POWER, AND THE POLITICS OF THE FEDERAL COURTS IN TWENTIETH-CENTURY AMERICA 201 (2000) (stating that one of the "primary goals" of Roosevelt's appointees to the Supreme Court was to "constrain the power of the federal courts"); RONEN SHAMIR, MANAGING LEGAL UNCERTAINTY: ELITE LAWYERS IN THE NEW DEAL 99–105 (1995) (describing New Deal lawyers' self-conscious effort to transfer power from courts to legislatures and agencies); William E. Forbath, *The New Deal Constitution in Exile*, 51 DUKE L.J. 165, 197 (2001) (stating that, in the eyes of New Deal advocates for workers' rights, "[t]he only important contribution the courts could make to this essentially political and legislative task was to allow the process to go forward").

5. GUIDO CALABRESI, *A COMMON LAW FOR THE AGE OF STATUTES* 44 (1982).

The statutorification of American Law can in one sense be dated from the New Deal. Although the process had long since begun and was to continue long after, the particular needs of the Great Depression, the desire to fashion a democratic welfare state in response to the influences of European fascism and Russian communism, and the frustrating slowness of the courts in accepting change, all made legislative lawmaking seem the appropriate solution.

Id. On the relationship of statutorification to the welfare state, see *id.* at 72–80. For a revisionist account emphasizing the long-run increase in legislation originating in the late 1800s that culminated in the 1930s, see William J. Novak, *The Legal Origins of the Modern American State*, in LOOKING BACK AT LAW'S CENTURY 249, 268–70 (Austin Sarat et al. eds., 2002).

6. See generally BARRY CUSHMAN, *RETHINKING THE NEW DEAL COURT* (1998); GILLMAN, *supra* note 1, at 175–93; WHITE, *supra* note 2, at 198–236. On the litigation strategies leading to this revolution, see generally PETER H. IRONS, *THE NEW DEAL LAWYERS* (1982).

7. WHITE, *supra* note 2, at 230 (citation omitted).

8. 304 U.S. 64 (1938).

9. This was in spite of their oft-expressed belief that the Constitution was not the proper basis for it. Robert H. Jackson, *The Rise and Fall of Swift v. Tyson*, 24 A.B.A. J. 609, 614, 644 (1938); PURCELL, *supra* note 4, at 195–97, 201–03.

10. PURCELL, *supra* note 4, at 214; see also Jackson, *supra* note 9, at 612.

11. See, e.g., Jackson, *supra* note 9, at 614 ("The most serious objection [to the pre-*Erie* regime] is

But even in this firmly established "Age of Statutes," the common law did not disappear altogether. It continued to play a role not only in state courts but also in federal ones, for the Supreme Court quickly made clear that federal common law would survive in certain areas where it was necessary to protect national interests.¹² Given that judges still needed to decide some cases by way of common law, how should they go about the task? On this matter, the newly ascendant progressive principles could be read in contradictory ways. They might suggest that the common law was suspect, since it called upon judges to exercise policy discretion even though they lacked the legislature's democratic accountability and its capacity to make comprehensive and prospective rules. One might argue that legal change therefore should happen only through the legislature. In other words, a legislature that did not alter the common law presumably wanted it to remain the same. But one could also make the opposite argument: if courts could not avoid making policy choices, let them embrace the task, especially now that the old-fashioned reverence for market rules had diminished. As to the question of what values should guide courts, let them follow the legislature. In a common law case, let the judge treat statutes in related areas of the law as if they were precedents, discerning the policies expressed in them and expanding those policies to cover new situations.¹³ This latter approach was the one more commonly endorsed by progressive jurists in the New Deal era.¹⁴ It allowed judges to exercise their talents while ostensibly honoring legislative supremacy. In a political sense, it was very convenient, since legislatures up to the late 1930s frequently expressed the kind of progressive economic values that New Deal jurists wanted judges to implement anyway. In fact, progressive jurists of the mid-twentieth century often lionized the common law and advocated judicial lawmaking to further their preferred policies even when the legislature

that the national legislature was powerless to alter rules of law after they were declared by the Federal courts in such matters as ordinary commercial law and torts." On the undemocratic nature of the pre-Erie regime, see PURCELL, *supra* note 4, at 141-91.

12. On the emergence and potential of specialized federal common law, see Henry J. Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U. L. REV. 383, 405-22 (1964).

13. For a theoretical treatment of these competing approaches to the common law in a statutory age, see Daniel A. Farber & Philip P. Frickey, *In the Shadow of the Legislature: The Common Law in the Age of the New Public Law*, 89 MICH. L. REV. 875, 888-905 (1991). The first of the two approaches has, interestingly, come to be associated with the judicial conservatism of the 1970s and 1980s.

14. See, e.g., James M. Landis, *Statutes and the Sources of Law*, in HARVARD LEGAL ESSAYS 213, 217-24, 230-31 (1934); Harlan F. Stone, *The Common Law in the United States*, Address Before the Conference on the Future of the Common Law (Aug. 19-21, 1936), 50 HARV. L. REV. 4, 12-15 (1936); Walter Gellhorn, *Principles of Legislation*, 21 IOWA L. REV. 167, 170 (1935) (reviewing HARVEY WALKER, *LAWMAKING IN THE UNITED STATES* (1934)). For a general treatment of this approach from the early progressives onward, see Robert F. Williams, *Statutes as Sources of Law Beyond Their Terms in Common Law Cases*, 50 GEO. WASH. L. REV. 554, 558-63 (1982).

did not actively prompt them.¹⁵ This occurred in fields where courts historically exercised *de facto* common law power in spite of statutes, such as corporate law and antitrust, as well as true common law fields like torts.¹⁶

The question of what role the common law should play in the New Deal state arose in yet another area: defense contracting. Scholars have overlooked the common law's place in this field, which is unfortunate, since it had potentially far-reaching consequences and sparked an intense and illuminating controversy. At the moment when President Franklin D. Roosevelt was trying to secure his legacy, Nazi Germany and imperial Japan forced the United States into total war. Although the war helped to render permanent the federal government's role in the economy, it also threatened to alter the balance of power within the government-business partnership.¹⁷ Despite the arrival of the "Age of Statutes," the administrative capacities of the state remained weak, particularly in the area of industrial management and planning.¹⁸ It was simply impossible for the United States to fight a total war without massive aid from large private corporations, who would quite naturally demand favorable treatment in exchange for their participation, just as they had in the First World War. The terms of the new bargain between government and big business were embodied, to a large extent, in the huge defense contracts that now took up much of the GDP, redistributing wealth and influencing the nation's industrial organization. When the nation entered the Second World War, defense contracts were still governed largely by common law. (Judges and lawyers seem to have assumed that, despite

15. See LAURA KALMAN, *LEGAL REALISM AT YALE, 1927-1960*, at 20-21 (1986) (noting that legal realists admired equity doctrines and summary judgment, precisely because they provided for broader judicial discretion, allowing judges to make the law fairer and more efficient); Karl N. Llewellyn, *American Common Law Tradition, and American Democracy*, 1 J. LEGIS. & POL. SOC. 14, 36-40 (1942) (praising a "grand style" in common law-making, characterized by the use of broad judicial discretion to meet the changing needs of society).

16. See ALAN BRINKLEY, *THE END OF REFORM: NEW DEAL LIBERALISM IN RECESSION AND WAR* 106-36 (1995) (describing New Deal lawyer Thurman Arnold's campaign to convince the federal courts to use antitrust law to implement his agenda of consumer protection); Adolph A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1932) (advocating an interpretation of corporate law to protect shareholders); George L. Priest, *The Invention of Enterprise Liability*, 14 J. LEGAL STUD. 461, 472, 483, 501-02 (1985) (describing how strict liability advocate Fleming James demanded legislation unsuccessfully in the 1930s before moving in the late 1940s to a strategy of treatise-writing to influence judges in common law cases, which proved highly successful).

17. The legal history of the Second World War is underexplored, particularly outside the area of constitutional law. A notable exception is *TOTAL WAR AND THE LAW: THE AMERICAN HOME FRONT IN WORLD WAR II* 121-207 (Daniel R. Ernst & Victor Jew eds., 2002) (containing essays on taxation, regulation, and administrative law, as well as constitutional law).

18. Problems of state administrative capacity deserve more attention in the legal history of the New Deal and of progressivism more generally. For a model, see THOMAS K. McCRAW, *PROPHETS OF REGULATION: CHARLES FRANCIS ADAMS, LOUIS D. BRANDEIS, JAMES M. LANDIS, AND ALFRED E. KAHN* 160-203 (1984) (emphasizing the attention paid by the early Securities and Exchange Commission to problems of enforcement).

Erie, it would be federal common law, as the Supreme Court confirmed without dissent in 1943–1944.¹⁹) Traditional common law doctrines would, of course, accord rock-solid security to the sometimes exploitative bargains that large contractors struck with a government in desperate need. Congress, once the friend and client of the New Deal lawyers, shifted rightward in 1938 and, during the period of rearmament that lasted from summer 1940 through the attack on Pearl Harbor in December 1941, legislated only weakly to rein in the contractors. The federal courts, now dominated by Roosevelt appointees and wielding common law power over defense contracts, stood in a position to influence the degree to which the Second World War would attenuate the legacy of the New Deal.²⁰ The progressive maxim that common law judges should follow the legislature gave them little help, as Congress seemed at best indifferent.

This did not stop the New Deal lawyers. Two days after Pearl Harbor and one day after the United States declared war on Japan and Germany, attorneys for the Roosevelt administration went before the Supreme Court to argue the final appeal in a bitter dispute against the Bethlehem Steel Corporation, the nation's largest defense contractor.²¹

19. *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366 (1943) (stating that federal common law governs the rights of the United States in recovering commercial paper); see also *United States v. Allegheny County, Pa.*, 322 U.S. 174, 183 (1944) (stating, without dissent on the point, that the “validity and construction” of federal contracts “present questions of federal law not controlled by the law of any state”). This rule was apparently generally assumed even before *Clearfield*, as demonstrated by the major federal contract case *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942), which will be the subject of this Article. The lower courts, both of which decided the case after *Erie* was handed down, failed to mention *Erie*. See *United States v. Bethlehem Steel Corp.*, 113 F.2d 301 (3d Cir. 1940); 23 F. Supp. 676 (E.D. Pa. 1938). When discussing the validity and construction of federal contracts, they cited no cases except federal and English ones. See *Bethlehem*, 113 F.2d at 306–08; 23 F. Supp. at 680–81. Before the Supreme Court, neither party mentioned *Erie* in its brief. See Briefs for Petitioners and Respondents, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9). The contractor cited only federal and English cases; the government cited cases from many jurisdictions but did not suggest that the law of any state controlled. *Id.* The Supreme Court concluded that it need not decide whether the case was governed by federal common law or state law, since the result would be the same regardless; the decision cited only federal law. *Bethlehem*, 315 U.S. at 299–300. The dissents neither cited *Erie* nor suggested that state law controlled. *Id.* at 312–37 (Frankfurter, J., dissenting), 338–42 (Douglas, J., dissenting). Although the opinion of the Court stated that the lower courts held the contracts to be governed by state law, *Bethlehem*, 315 U.S. at 295–96, 299 n.9, this was apparently mistaken. The lower courts mentioned state law only when discussing the award of interest on the judgment, apparently drawing upon a rule unrelated to *Erie*. *Bethlehem*, 113 F.2d at 308 (conditioning application of the rule on the contracts’ “place of performance,” which was irrelevant to *Erie*); *Bethlehem*, 23 F. Supp. at 681–82 (referring to a statement of state law by the Special Master, who submitted his report before *Erie* was even handed down).

20. The mediation of public governance through the structures of government contracting in the present day has been analyzed at length in Jody Freeman, *The Contracting State*, 28 FLA. ST. U. L. REV. 155 (2000); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000).

21. *Bethlehem*, 315 U.S. at 289. On Bethlehem's status, see Robert Higgs, *Private Profit, Public Risk: Institutional Antecedents of the Modern Military Procurement System in the Rearmament Program, 1940–41*, in *THE SINEWS OF WAR: ESSAYS ON THE ECONOMIC HISTORY OF WORLD WAR II*, at

They tried to convince the Court that federal judges ought to rein in the prices of defense contracts, using the doctrine of economic duress. In time of war, so the argument went, the nation depends on defense contractors for its very life, and these private firms should not be permitted to exploit public necessity for inordinate gain. This argument, had it succeeded, would have constituted perhaps the largest expansion of judges' common law power over big business during the twentieth century. However, the Court rejected the argument. The newly appointed Justice Jackson, in his previous post as Attorney General, had embraced the duress theory and adopted the case as a personal mission. Recused from taking part in the decision, he blasted it as "the dirtiest day's work the Court has ever done and a defeat for the Government worse than Pearl Harbor."²² Jackson's lone consolation was an impassioned dissent from Justice Felix Frankfurter, who argued that the government's "dependent position" in wartime meant that courts should treat defense contractors like public trustees. Thus did Jackson and Frankfurter—two men strongly associated with the New Deal tradition of judicial restraint—advocate a radical innovation in the common law to govern the nascent military-industrial complex. One contemporary dubbed *Bethlehem* a "crossroads decision," on a par with *McCulloch* and *Lochner*, in terms of its consequences for judicial power.²³ Surprisingly, scholars have given this remarkable case no serious attention since the Second World War.²⁴

This Article tells the forgotten story of *United States v. Bethlehem Steel Corporation*. The tale is a mixture of epic and farce. Although the final decision came down just as the United States was beginning to fight the Second World War in 1942, the dispute arose from a transaction that took place during the First World War, in 1917–1918. Back then, the government had been desperate for tankers and cargo vessels to transport men and supplies across the Atlantic to save Britain and France from imminent collapse. Bethlehem, the largest shipbuilding company in the world, contracted with the government to build a big

171, 186 (Geoffrey T. Mills & Hugh Rockoff eds., 1993).

22. Letter from Justice Robert H. Jackson to Justice William O. Douglas (Feb. 9, 1942) (Folder labeled "Legal File—Supreme Court O.T. 1941—Cases Nos. 8, 9—U.S. v. Bethlehem Steel Corporation," Box 122, Robert H. Jackson Papers, Manuscripts Division, Library of Congress, Washington, D.C.) [The Robert H. Jackson Papers at the Library of Congress are hereinafter referred to as RHJ-LC].

23. Walter B. Kennedy, *The Bethlehem Steel Case—A Test of the New Constitutionalism I*, 11 FORDHAM L. REV. 133, 139 & n.23 (1942).

24. The only piece since World War II to treat the *Bethlehem* case at any length is John W. Whelan & Steven B. Mains, "Cost Plus" or "I May Be a Robber But I'm Not a Thief," 8 PUB. CONT. L.J. 210 (1976). This twelve-page essay presents no sources on the case aside from the opinions themselves, never citing the parties' briefs or the Master's Report. *Id.* It is generally devoid of historical context, though it briefly touches on one point analyzed in much more depth in this Article: the problem of how to distribute the high risk of war production. *Id.* at 211–13.

chunk of this new fleet; the contract exceeded one billion dollars in today's currency. Bethlehem demanded complete protection from the risk of loss, plus a very favorable price formula. Government negotiators acquiesced. When the accounts were settled, the riskless contract yielded a profit of a quarter billion dollars in today's currency, or twenty-two percent on cost. Government officials denounced the profit as unconscionable and resolved that Bethlehem should not be paid in full. Toward this end, attorneys handling the case in the lower courts invoked a wide variety of legal theories, all doomed to failure. Meanwhile, a combination of bad luck and incompetence delayed the litigation for many years. This proved fortuitous, for when the case reached the stage of final appeal in 1940, Jackson and his New Deal colleagues seized upon it as an instrument to limit the power of the rapidly expanding defense industry. Dropping or deemphasizing the previous, unsuccessful theories, they adopted the novel theory of duress and made it their main argument.

To our ears, it may sound bizarre and even absurd that the government claimed to be the victim of duress at the hands of a private company. This puzzle is the subject of Part I of this Article, which recreates the economic context of total war. In wartime, the state was legally authorized to seize any company it wished. At first glance, it seems reasonable to assume that such power placed the government in a strong bargaining position. As a matter of fact, however, that assumption is wrong (at least in the case of large firms). To win a total war, the state had to maximize production. Because the U.S. government lacked an industrial management bureaucracy of its own, it had to rely on the one that already existed in the nation's private firms. Seizing a company and replacing its management with government personnel reduced efficiency and undermined the war effort. Hence, when the government did use the power of eminent domain, it was almost exclusively in cases where the existing private managers, for whatever reason, were producing so little that a seizure, with all its disadvantages, would still help production. Such was not the case for large, well-run firms like Bethlehem. Therefore, these contractors were able to drive hard bargains and extract rents. What is more, total war created extreme cost uncertainty, meaning that the government either had to pay its contractors huge risk premiums or protect them against losses, which in turn encouraged them to run up costs.

Taken together, these factors resulted in a waste of public money that hampered efficient procurement and sapped national morale. To meet the challenge, Congress—in April 1942, two months after the government's defeat in *Bethlehem*—finally settled on a second-best solution known as the Renegotiation Act, giving the government unilateral power to re-price war contracts during or after performance,

once better cost information was available and the government's bargaining position was stronger. However, this solution was politically precarious. Before the Act's passage, especially in the pro-business climate of rearmament during 1940–1941, New Deal lawyers had been terrified that Congress would allow the defense industry to rob the government blind. The theory of duress in *Bethlehem* was their fallback amid fear that Congress would never act.

After setting forth this context, this Article then unfolds the story of the case itself. Part II considers the facts, particularly the government's desperate scramble for merchant vessels during World War I, its abject dependence on Bethlehem's mighty organization, and the ultimate question of whether the transaction really left the government worse off than other alternatives. Next, Part III examines the government's hapless efforts in the lower courts during the 1920s and 1930s to bend and stretch the common law—particularly the doctrines of consideration, misrepresentation, and fiduciary duty—to redress the pathologies of defense contracting.

These weak theories faded to the background once Jackson and his colleagues plucked the case from obscurity amid the maelstrom of rearmament and adopted a theory of relief—duress—that fit their aim to prevent corporate rent-seeking. The duress theory and its far-reaching implications are the subject of Part IV. At the outset, Part IV.A explains that the Justice Department was attempting to set a major new precedent. Next, Part IV.B notes that the Supreme Court almost refused to hear the case, since so many of the Justices had participated in it during their prior careers in government service.

Part IV.C explains the role of the case in the national controversy over government-business cooperation. By accusing a big corporation of coercing the government, New Deal lawyers struck a major blow in that controversy. Advocates of corporatism had long urged that oligopoly and collusion were good. By their reasoning, high profits encouraged investment, and the control of markets by rational administration prevented waste, lowered risk, and softened the business cycle. In light of this, corporatists believed that the government should accept the power of big business and cooperate with it to manage the economy. From the corporatist perspective, total war was a golden opportunity, for the necessity of centrally managed mobilization gave corporate leaders the chance to prove that close business-government cooperation was an effective way to meet public goals. Opponents of this vision—Jackson foremost among them—argued that governmental bureaucratic capacity was so weak in comparison to that of corporations that the state could never be an equal partner in cooperation with big business. Such “cooperation” would merely allow business to leverage its superior administrative capacity in order to extract favors from the state.

Although Jackson and his allies were deeply committed to the struggle against Germany and Japan, they wanted to ensure that this necessary war would not become an excuse for corporatists to impose their agenda. The *Bethlehem* case was the perfect example of a corporation's ability to extort favors when the government stood in need of its administrative capacity. This helps explain why Jackson took up the litigation as a personal mission.

The Justice Department's purpose was to alter economic policy, yet its means were the common law. As noted above, New Deal jurists, particularly Robert L. Hale, sought to overturn the traditional view of the market as a domain of freedom. This meant the Justice Department had to grapple with the doctrine of duress at a time when the very notions of contract, consent, and coercion were in flux. Indeed, as Part IV.D explains, the Justice Department's duress theory reflected a major doctrinal innovation. At the time, there were two traditional common law formulations of duress, neither of which helped the Justice Department much. In the first version, the doctrine required that the duressor's threat overcome the will of the victim. But this happened by definition in any bargain, so the formulation was incoherent and unhelpful. In the second version, duress required that the threat be wrongful, that is, criminal, tortious, or immoral. But the only threat that Bethlehem had made was to refrain from entering the contract. In a free market, that could not be wrongful. Clearly, the Justice Department needed to find some other strategy. It found it in a series of cases for which the requirement of a wrongful threat offered no explanation: cases in which courts found duress simply because one party took advantage of the other's dire need. In light of this, the Justice Department—apparently inspired by the scholarship of Hale and his disciple John P. Dawson—defined duress as the substantive unfairness of an exchange amid conditions of extreme necessity. Courts ordinarily evaluated the fairness of an exchange by measuring it against the market price, but since no working market existed in total war, the Justice Department effectively asked judges to become regulators, re-pricing contracts so as to incentivize cost reduction, optimize investment, and enforce standards of distributive justice that were intuitively acceptable to the community. As their model, attorneys focused upon an ancient and well-established area of judicial regulation of price: contracts in admiralty for the rescue of ships in distress.

Part IV.E explains how the duress theory posed a dilemma for the tradition of judicial restraint. While the duress theory harmonized with the New Deal mission to control the power of big business, it clashed with the New Deal's equally important mission to limit the power of the courts, since the adoption of the theory would have required judges to play a big role in economic regulation. Granted, the clash was not quite

as severe as it might seem. Judicial re-pricing of defense contracts would take place only with the tacit permission of Congress (since the power originated from the common law rather than the Constitution) and with the authorization of the executive (which would decide whether to make the claim in the first place). Still, considering how much Jackson and Frankfurter lambasted judicial meddling in the years up to 1940, their passionate devotion to the duress theory is rather shocking, especially considering that Justice Hugo Black, writing for the majority, emphasized that Congress had chosen to buy war materiel on the free market and that judges would overstep their bounds if they tried to rescue Congress from the consequences of its policy choice. Jackson's support for the duress theory reminds us that his commitment to judicial restraint was always a pragmatic means toward a larger end of distributive justice. As to Frankfurter, his argument in favor of the theory reflected his admiration for common law creativity—shared by many progressives—tempered by his desire to present the theory as a logical application of historically recognizable principles. In response to Black's unrealistic hope that a defeat in the *Bethlehem* case would force the government to take over the defense industry, Frankfurter insisted that acceptance of the duress theory represented its own kind of judicial restraint: it was practically impossible for the government to seize and operate industry during wartime, and if Congress chose not to attempt such a radical and futile solution, the courts had to respect the political branches' assessment of their own limitations, not punish them by refusing to enforce the limits on market exploitation that were historically grounded in the common law.

I. THE CONTEXT: CONTRACTING IN TOTAL WAR

Imagine the consequences if the Supreme Court had accepted the government's theory of duress in the *Bethlehem* case. Every wartime agreement between the government and a contractor with significant market power would have been subject to judicial re-pricing after performance. At first glance, this kind of assault on the security of contracts may seem crazy, with repercussions too radical even for New Deal lawyers. But while the theory was unprecedented, the problems it aimed to solve were equally so, arising as they did from the novel catastrophe of total war. This Part therefore seeks to place the theory within the larger context of the time, with a particular focus on the way national mobilization in both the First and Second World Wars redistributed bargaining power, created extreme cost uncertainty, and made it harder to devise efficient incentives. Against this background, it becomes clear that re-pricing after performance represented a plausible second-best solution. Congress' eventual formulation of that solution, from a functional standpoint, differed somewhat, though not

fundamentally, from the duress theory, as the final Section of this Part will show.

A. THE CONTRACTOR'S ADVANTAGE IN BARGAINING POWER

During total war, it was common for the government and a contractor to find themselves in a bilateral monopoly. On the one hand, the government frequently required all or nearly all the output of an entire industry, so that "each individual firm [in that industry] tended to become a monopoly or 'sole source' for additional . . . items of required procurement."²⁵ On the other hand, the government in wartime controlled the allocation of supplies, meaning that if a firm refused to accept its orders, the government could shut down that firm completely.²⁶ This made the government a monopolist from the firm's point of view.

Within this bilateral monopoly, the contractor generally stood to get an excellent deal.²⁷ First, procurement officers placed a tremendously high value on victory and the means to achieve it. Bernard Baruch, who became the nation's "economic czar" during World War I as chairman of the War Industries Board (WIB), stated the matter simply: "You could be forgiven if you paid too much to get the stuff, but you could never be forgiven if you did not get it, and lost the war."²⁸ In the early phase of World War II, this "sense of overriding urgency" gave rise to "production 'at any price.'"²⁹ Senator Harry S. Truman described the Army's procurement chief in this way: "I will say this for General Somervell, he will get the stuff, but it is going to be hell on the taxpayer."³⁰

A second factor also favored the contractor: the passage of time during which the parties failed to reach an agreement cost the government more than it did the contractor. Days lost before the start of production meant ordinary monetary losses for the firm, but for the military they meant fighting the enemy at less than full strength. Procurement officers could expect their superiors to overlook a high

25. R. ELBERTON SMITH, *THE ARMY AND ECONOMIC MOBILIZATION* 313 (1959).

26. STUART D. BRANDES, *WARHOGS: A HISTORY OF WAR PROFITS IN AMERICA* 171 (1997); J. FRANKLIN CROWELL, *GOVERNMENT WAR CONTRACTS* 47 (1920). On the priorities system more generally, see BERNARD BARUCH, *AMERICAN INDUSTRY IN THE WAR* 47-60 (1941).

27. The following discussion draws on Abhinay Muthoo, *A Non-Technical Introduction to Bargaining Theory*, 1 *WORLD ECONOMICS* 145, 146-48, 150-52 (2000).

28. MELVIN I. UROFSKY, *BIG STEEL AND THE WILSON ADMINISTRATION: A STUDY IN BUSINESS-GOVERNMENT RELATIONS* 234 (1969) (citation omitted). See also Urofsky's discussion, leading up to this quotation, of the willingness of the government in wartime to pay disproportionate prices for relatively small increases in output. *Id.* at 233-34; see also H. Struve Hensel & Richard D. McClung, *Profit Limitation Controls Prior to the Present War*, 10 *LAW & CONTEMP. PROBS.* 187, 212 (1943) (quoting the Undersecretary of War in 1942 that "the armed forces 'are more interested in getting the goods than anything else'").

29. SMITH, *supra* note 25, at 275.

30. *Id.* at 276 n.64 (citation omitted).

price, but they knew they would be flayed if they let down the troops by failing to deliver on time.³¹

A third and final factor relevant to bargaining was the government's legal authority to order the firm to accept a certain price, backed up by the power to seize and operate the firm itself. At first glance, this may seem like a huge advantage for the government. In World War I, noted Baruch, "the power to commandeer" served "as the effective persuasive force which vitalized the whole program of regulation," though it "remained in the background" and was "very rarely used."³² Likewise in World War II, asserted an official Army historian, the "compulsory pricing powers of the War Department . . . exerted a substantial influence in obtaining contractor co-operation," even though they "were seldom specifically invoked."³³

However, when one checks these generalizations against the available evidence (including some of Baruch's *other* statements), it becomes clear that their sanguine view of the power to commandeer is exaggerated. As a practical matter, the government under most circumstances could not seize and operate a large firm like U.S. Steel or Bethlehem Steel (nor even, probably, a large number of lesser firms). To understand why, we must first examine some larger issues in the history of the American state.

1. *The Government's Wartime Dependence on Private Administrative Capacity*

A public policy means nothing if the government does not have access to personnel sufficiently knowledgeable and organized to implement it. Finding, training, and assembling these kinds of personnel into an effective bureaucracy often takes years. Thus, the prior historical development of administrative capacities limits the realm of feasible government action.³⁴

This fact had serious consequences for the United States during both wars. At the declaration of war in spring 1917 and again at the start of rearmament in summer 1940, the nation emerged from a period of relative isolationism and of production far below the demands of total war. Hence, the government had precious little time to effect the increase in volume and the conversion and expansion of plant necessary for military supply. And in total war, time is everything. The longer it takes to win the war, the greater the number of people who die. And the

31. BRANDES, *supra* note 26, at 147 (World War I); BRIAN WADDELL, *THE WAR AGAINST THE NEW DEAL: WORLD WAR II AND AMERICAN DEMOCRACY* 96 (2001) (World War II); *see also* Transcript of Record at 1616-18, 1620, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (No. 8) (1942).

32. BARUCH, *supra* note 26, at 390.

33. SMITH, *supra* note 25, at 279.

34. *See* Theda Skocpol & Kenneth Finegold, *State Capacity and Economic Intervention in the Early New Deal*, 97 POL. SCI. Q. 255, 275-78 (1982).

longer the delay in obtaining supplies, the greater the risk of defeat. In spring 1918, for instance, Germany bet everything in an all-out attempt to smash the French and British before sufficient American reinforcements could get across the Atlantic.³⁵ To maximize production as fast as possible, the United States government would have to take advantage of whatever industrial management capacity already existed. At the advent of both World Wars, that particular type of administrative capacity was concentrated largely in private corporations.

The origins of this concentration lay deep in U.S. history. When Europeans colonized North America, they did not bring with them a cohesive administrative elite.³⁶ In this vacuum, electoral democracy developed in the early 1800s, creating a national bureaucracy in the form of the political parties and the local patronage networks they sponsored. As the economy rapidly developed, the goal of these patronage networks was to distribute development opportunities to private parties in order to win their political loyalties, not to manage production themselves.³⁷ Once established, the patronage system made it hard for the government to acquire administrative capacities that required expertise or independent professional judgment, since the parties (and the different branches of government) would compete for control of any bureaucratic additions and interfere with their design.³⁸ With governmental modernization so constrained, private firms, encouraged by legislative grants of power and a friendly judiciary, recruited and trained a class of salaried executives to make the specialized, coordinated, moment-to-moment decisions of manufacturing, transportation, and resource extraction.³⁹ Though the federal government did acquire effective administration in a few areas by the 1910s,⁴⁰ the ability to manage industrial production was to be found

35. MEIRION HARRIES & SUSIE HARRIES, *THE LAST DAYS OF INNOCENCE: AMERICA AT WAR, 1917-1918*, at 208-09 (1997); see also EDWARD N. HURLEY, *THE BRIDGE TO FRANCE* 119 (1927) (quoting the British Prime Minister).

36. See generally Thomas K. McCraw, *Business & Government: The Origins of the Adversary Relationship*, 26 CAL. MGMT. REV. 33, 42-43 (1984).

37. See generally RICHARD L. MCCORMICK, *THE PARTY PERIOD AND PUBLIC POLICY: AMERICAN POLITICS FROM THE AGE OF JACKSON TO THE PROGRESSIVE ERA 197-227* (1986).

38. See STEPHEN SKOWRONEK, *BUILDING A NEW AMERICAN STATE: THE EXPANSION OF NATIONAL ADMINISTRATIVE CAPACITIES* (1982).

39. On the development of business bureaucracies, see ALFRED D. CHANDLER, JR., *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* (1977). On the role of the judiciary in fostering the rise of corporate capital, see RICHARD BENSEL, *THE POLITICAL ECONOMY OF AMERICAN INDUSTRIALIZATION, 1877-1900*, at 321-49 (2000); HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW, 1836-1937* (1991). On the role of state legislatures in the rise of corporations, see WILLIAM G. ROY, *SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA* 41-97, 144-75 (1997).

40. See DANIEL P. CARPENTER, *THE FORGING OF BUREAUCRATIC AUTONOMY: REPUTATIONS, NETWORKS, AND POLICY INNOVATION IN EXECUTIVE AGENCIES, 1862-1928* (2001) (comparing the success of the U.S. Post Office and U.S. Department of Agriculture with the failure of the U.S. Department of the Interior); Skocpol & Finegold, *supra* note 34, at 271-75 (chronicling the success of the U.S.

overwhelmingly among the employees of private firms and in those firms' preexisting patterns of organization.⁴¹ President Woodrow Wilson, having won the White House on an anti-corporate platform, soberly recognized this fact. "If we enter this war," he privately conceded, "the great interests which control steel, oil, shipping, munitions factories, mines, will of necessity become dominant factors."⁴²

The situation was substantially similar on the eve of World War II. While the New Deal increased the number of federal personnel by sixty percent, fighting the Axis would require an expansion of approximately three hundred percent.⁴³ Besides, little of the bureaucratic expansion of the New Deal came in the area of industrial management.⁴⁴ President Franklin D. Roosevelt's efforts to improve the government's deficient capacity for economic planning had foundered in Congress in 1937–1939.⁴⁵ As a leading historian of the period concludes, "there existed no administrative mechanisms within the government capable of handling the enormous new tasks the war had imposed on it."⁴⁶ To maximize production on short notice, reliance on private business was by far the surest option.⁴⁷ At the very least, the most immediate, on-the-ground tasks of industrial management would have to be performed primarily by corporations themselves.

The government's grave need for administrative personnel was also evident in the staffing of wartime agencies. War required the government

Department of Agriculture).

41. On the dependence of government on much better developed private bureaucracies specifically on the eve of World War I, see ROBERT D. CUFF, *THE WAR INDUSTRIES BOARD: BUSINESS-GOVERNMENT RELATIONS DURING WORLD WAR I*, at 9, 41, 269 (1973). For an overview of the disgraceful state of government organization for war in 1917, see HARRIES & HARRIES, *supra* note 35, at 193–204. For more general statements on the superior development of private over public organization in the early twentieth century, see McCraw, *supra* note 36, at 44–45; Skocpol & Finegold, *supra* note 34, at 261–68. On the separateness of industrial and government bureaucracies, see Alfred D. Chandler, Jr., *Business Versus Government: An American Phenomenon*, in *BUSINESS AND PUBLIC POLICY I* (John T. Dunlop ed., 1980).

42. UROFSKY, *supra* note 28, at 150–51 (citation omitted).

43. Kim McQuaid, *Corporate Liberalism in the American Business Community, 1920–1940*, 52 *BUS. HIST. REV.* 342, 364 (1978).

44. BRINKLEY, *supra* note 16, at 177.

45. See RICHARD POLENBERG, *REORGANIZING ROOSEVELT'S GOVERNMENT: THE CONTROVERSY OVER EXECUTIVE REORGANIZATION, 1936–1939*, at 28, 162–66, (1966); Otis L. Graham, Jr., *The Intended New Deal*, in *ESSAYS IN HONOR OF JAMES MACGREGOR BURNS 75* (Michael R. Beschloss & Thomas E. Cronin eds., 1989). On the general resistance to the creation of a cohesive and effective bureaucracy throughout the New Deal, see Ellis W. Hawley, *The New Deal State and the Anti-Bureaucratic Tradition*, in *THE NEW DEAL AND ITS LEGACY: CRITIQUE AND REAPPRAISAL 77* (Robert Eden ed., 1989).

46. BRINKLEY, *supra* note 16, at 177.

47. Robert D. Cuff, *Comment* on Paul A.C. Koistinen, *Warfare and Power Relations in America: Mobilizing the World War II Economy*, in *THE HOME FRONT AND WAR IN THE TWENTIETH CENTURY: THE AMERICAN EXPERIENCE IN COMPARATIVE PERSPECTIVE*, at 111, 115–17 (James Titus ed., 1984) (noting that the government's lack of a permanent higher civil service necessitated dependence on private bureaucracies during World War II).

to make rapid and complex purchasing decisions. The existing civil and military services had neither the number nor the quality of people to do this. When the nation entered World War I, the Army Ordnance Corps (its primary procurement mechanism) had a staff of only ninety-six. The war, as soon became clear, would require about five thousand.⁴⁸ The lessons of this desperate scramble appear to have been forgotten by the next war, for in 1940, the Ordnance Corps' successor agencies were considered "mere skeleton organizations" and dumping grounds for stalled military careers. Even after Pearl Harbor, several of the "statisticians" in the office of the Army's Chief of Statistics were former cavalry men who needed to be placed somewhere now that their skills were obsolete.⁴⁹ To fill these procurement posts in 1917 and 1940, particularly the more challenging high-level ones, the most ready candidates were people with business backgrounds, whom the government retained in large numbers.⁵⁰

Nor was procurement the only void within the government. Total war required a level of central economic planning never seen before or since in U.S. history. Governmental machinery suited to this particular task simply did not exist in 1917. The classic treatment of World War I planning characterizes the initial setting as an "organizational vacuum."⁵¹ Granted, some of the higher-level planning posts, in contrast to those in direct production management and procurement, required less specialized knowledge of a particular industry, so these posts could be filled by academics and others without business backgrounds.⁵² However, the sheer number of personnel required and the need for highly specialized knowledge in the case of industry-specific planning meant the government could not avoid recruiting businessmen.⁵³

To induce highly experienced or influential executives to enter public service, the government frequently agreed to pay them one dollar per year with the understanding that they would continue to receive large salaries from their private employers during their public service. The retention of these "dollar-a-year men" sparked congressional criticism. The vehemence with which top executive officials (even those who were *not* pro-business) proclaimed their need for the dollar-a-year men underlined the government's lack of short-run alternatives. In

48. BRANDES, *supra* note 26, at 144; *see also* CROWELL, *supra* note 26, at 151 (stating that the navy procurement staff grew fourteen-fold).

49. WADDELL, *supra* note 31, at 97-98.

50. *See generally* DAVID M. KENNEDY, *OVER HERE: THE FIRST WORLD WAR AND AMERICAN SOCIETY* 126-29 (1980) (World War I); WADDELL, *supra* note 31, at 97 (World War II).

51. CUFF, *supra* note 41, at 43.

52. The best example is the economist Leon Henderson. *See* BRINKLEY, *supra* note 16, at 146-48.

53. For example, the Office of Production Management, which handled civilian production during rearmament before World War II, drew only seven percent of its top officials from universities, foundations, and labor unions. WADDELL, *supra* note 31, at 76.

response to complaints from a populist Senator, Wilson wrote privately that "I should find myself hampered in a degree which I think you cannot realize if I were deprived of the opportunity to use these gentlemen as they are willing to be used."⁵⁴ During World War II, Donald M. Nelson, chairman of the War Production Board and a supporter of the New Deal, vigorously defended his employment of hundreds of dollar-a-year men. "In order to get maximum results from American industry," he told a Senate committee, "we must have in government men who understand and can deal with its intricate structure and operation. . . . Such men must be drawn in large measure from industry itself."⁵⁵

None of this is to say that the U.S. government was inherently incapable of acquiring the capacity to manage industry or even to create public enterprises. It is only to say that such projects took years to come to fruition, in contrast to the short time-frame of war. Consider the Navy yards, whose job was to construct and equip warships. Rendered ineffective by pork-barrel inefficiency through the early 1880s, these facilities benefited over the next four decades from a series of incremental management reforms, which Navy officials often had to wrest from a reluctant Congress.⁵⁶ By World War I, the yards were able to make a valuable contribution. But the government usually did not have the luxury of such a long incubation period for its projects. For instance, before World War I the government had never attempted to produce armor plate, a key input for warships. Congress in summer 1916 authorized the Navy to build its own plant for that purpose.⁵⁷ Though one official touted this project as the harbinger of a "new national policy in the making of weapons," the Navy lacked the expertise for fast construction, and the government preferred to allocate resources not to the building of the plant, but to the construction of ships, for which its need was far more desperate.⁵⁸ Ultimately, experienced private firms fulfilled the government's need for armor plate throughout the war. Meanwhile, the Navy plant "never produced sizable quantities" and, after peace returned, rusted into oblivion.⁵⁹

This debacle typified the irony of military production in the era before 1945. In peace, there was little political will to build up state war-making capacity. The exceptional case of the Navy yards stems largely

54. UROFSKY, *supra* note 28, at 169 (citation omitted).

55. DONALD M. NELSON, *ARSENAL OF DEMOCRACY: THE STORY OF AMERICAN WAR PRODUCTION* 333 (Da Capo Press, 1973) (1946).

56. PAUL A. C. KOISTINEN, *MOBILIZING FOR MODERN WAR: THE POLITICAL ECONOMY OF AMERICAN WARFARE, 1865-1919*, at 20-21, 28-30, 33, 36, 44-46 (1997).

57. BENJAMIN FRANKLIN COOLING, *GRAY STEEL AND BLUE WATER NAVY: THE FORMATIVE YEARS OF AMERICA'S MILITARY-INDUSTRIAL COMPLEX, 1881-1917*, at 203-04 (1979).

58. *Id.* at 210-11 (citation omitted).

59. *Id.* at 211-12.

from the fact that the fleet had a larger peacetime role than any other military unit.⁶⁰ When the possibility of a broader conflict became serious, as in 1916–1917 or 1940–1941, the emergency imposed a timetable measured in months rather than decades, leaving the government no time to restructure its relation to industry.

2. *Eminent Domain as an Empty Weapon*

In wartime, the government's overriding goal with respect to most products and services was to reach maximum production as fast as possible and stay there. This was the key to winning the war and halting the death and suffering. Speed came first, far ahead of monetary cost.⁶¹ In light of the paramount goal of maximum production in most industries, it was rational for the government to take over a plant in such an industry only when doing so was expected to result in greater production. A government takeover would be counterproductive where the firm already operated as efficiently as possible, because seizure invariably caused certain inefficiencies. The substitution of new management, however qualified, entailed a period of adjustment. If good managers were to be substituted, they had to be taken away from other posts where they were needed, since qualified managers in many industries were fully employed in total war. If qualified managers could not be spared anywhere else, novices had to be substituted, causing obvious inefficiency. One could, of course, conscript a plant's existing managers to continue operations after seizure under threat of criminal penalties, but this was outside the realm of political possibility in both wars.⁶²

In the case of a big firm with complex facilities that runs relatively well, management by any group besides the current staff will delay maximum production for quite some time. Consider the impasse between the WIB and the steel industry over prices in 1918. Amid heated

60. On naval requirements, see GEORGE T. DAVIS, *A NAVY SECOND TO NONE: THE DEVELOPMENT OF MODERN AMERICAN NAVAL POLICY* (1940). Isolationists argued in the 1930s that the munitions industry should be nationalized, but they did so on the assumption that such an industry would remain small and little-used. MATTHEW WARE COULTER, *THE SENATE MUNITIONS INQUIRY OF THE 1930S: BEYOND THE MERCHANTS OF DEATH* 132–33 (1997).

61. Special Comm. on Investigation of the Munitions Industry, *Preliminary Report on Wartime Taxation and Price Control*, S. REP. NO. 74–944, pt. 2, at 4 (1935) [hereinafter Nye Comm. Report]; CROWELL, *supra* note 26, at 36.

62. In wartime, the government and the public put their faith in voluntarism in dealing with business. See CUFF, *supra* note 41, (World War I); DAVID M. KENNEDY, *FREEDOM FROM FEAR: THE AMERICAN PEOPLE IN DEPRESSION AND WAR, 1929–1945*, at 622–23 (World War II). The reluctance of U.S. officials to use imprisonment as an ordinary means of wartime business regulation is evident from the weak enforcement of criminal penalties for businessmen's widespread violations of price regulations during World War II. MARSHALL B. CLINARD, *THE BLACK MARKET: A STUDY OF WHITE COLLAR CRIME* 238–46, 293–97 (Patterson Smith 1969) (1952). Note that proposals to “draft industry”—which received political attention in the interwar period, when no actual war was contemplated—were usually coupled with proposals to draft labor. Labor therefore opposed them vehemently. BRANDES, *supra* note 26, at 191, 206, 230.

negotiations, Baruch threatened to seize the U.S. Steel Corporation. Its president, Elbert Gary, replied sharply, "You haven't got anybody to run the Steel Corporation." Baruch dodged this challenge with a dismissive joke: "[W]e'll get some second lieutenant or somebody to run it."⁶³ But after the war, Baruch—despite the vague generalizations that he made elsewhere touting the power to commandeer—admitted that he had been bluffing. "If your bluff had been called," a Senate investigator asked him, "what would you have been able to do?" "I would have been in a devil of a fix," Baruch conceded. He would have tried to get one of the executives to stay on and run the plant, but if that did not work, "I do not know how we would have worked it [the seizure]. It was not very clear in my own mind." Whenever the WIB had considered seizing a major plant, Baruch explained, it ran into difficult questions: "Who will run it? . . . Would you replace a proved expert manager by a problematical mediocrity?" In light of these difficulties, Baruch concluded that, even if government management "could prove adequate to the task (which it could never do) the mere process of change would destroy efficiency at the outset."⁶⁴ Baruch's conclusion was accepted even at the other end of the political spectrum, among the anti-business and isolationist Senators who made up the committee that interrogated him. The committee concluded that the "apparent alternative of commandeering industry is in fact not an available alternative."⁶⁵

When the government did take the unusual step of seizing a firm, it did so almost exclusively in cases where the current private management, for whatever reason, was operating with such egregious inefficiency that a government takeover, despite all its drawbacks, would still be better for production. Even in these cases, the government's usual policy was to rely as much as it could on the managers already in place.

The chief example is the seizure of the railroad industry in World War I. The Wilson administration took this drastic approach because of the railroads' total inability to meet wartime demand. The problem began about ten years before the war started when shippers had pressured regulators to keep rates very low. Consequently, the railroads made too little money to attract capital, and so they underinvested in cars, resulting in a shortage when the war started. Ideally, the railroads

63. UROFSKY, *supra* note 28, at 214 (citation omitted).

64. Nye Comm. Report, *supra* note 61, at 113–14, *reprinted in* BARUCH, *supra* note 26, at 406. Edward N. Hurley, who ran one of the government's largest wartime operations as chair of the Shipping Board, agreed. At a war cabinet meeting, somebody suggested a takeover of the steel industry, but Hurley spoke up against it. The "subject was passed over with very little further discussion, and never again was it seriously considered." If the government had taken over the steel plants, said Hurley in retrospect, the industry's "efficiency would be reduced 50 per cent. within six months." HURLEY, *supra* note 35, at 178.

65. Nye Comm. Report, *supra* note 61, at 4.

were to transport war materiel to the Atlantic ports to be loaded on ships, along with coal to fuel the ships. However, because there were so few cars, the re-fueling of ships slowed down. With fewer ships departing, cars in the Atlantic ports piled up in the terminals because they could not be unloaded. This congestion, in turn, prevented new cars from reaching the ports to re-fuel the ships, creating a vicious cycle. By Christmas 1917, the back-up threatened to cut off coal to a large chunk of the Northeast and shut down the war plants there. Untangling this mess would require a massive coordinated effort, and if managers worried about getting favorable treatment for the cars that belonged to their firms, it would never work.⁶⁶

With private ownership standing in the way of efficient service, the government took over. Even then, actual government administrators were confined to a single coordinating office in Washington; except in a few cases, the day-to-day operation of each line remained in the hands of the respective current managers, who acted on behalf of the government for purposes of the seizure.⁶⁷ The government had sufficient bargaining power to get the managers to fill this role because the railroads were in extreme financial distress and would require generous government support if they were ever to become profitable again.⁶⁸ Hence, the conditions that made seizure desirable and workable for the government would have been completely absent in the case of a prosperous firm, such as Bethlehem, whose managers were better suited than anybody else to conduct operations.⁶⁹

The two other industry-wide seizures of the war taught similar lessons. In the case of ocean shipping, government control permitted the high coordination necessary to transport and supply an army, but which the market could not provide.⁷⁰ Like the railroads, shipping firms remained under the immediate control of their existing management.⁷¹

66. The foregoing discussion is from AARON AUSTIN GODFREY, *GOVERNMENT OPERATION OF THE RAILROADS, 1918-1920: ITS NECESSITY, SUCCESS, AND CONSEQUENCES 1918-1920*, at 3-46 (1974).

67. *Id.* at 48-51.

68. *Id.* at 35, 65 (describing the railroads' dire need for government favors).

69. Admittedly, Bethlehem took on more contracts than it could handle during World War I. HARRIES, *supra* note 35, at 286. But there is no suggestion that any other management could have accomplished the firm's work better.

70. HURLEY, *supra* note 35, at 98, 101, 104-05; see also Edmund E. Day, *The American Merchant Fleet: A War Achievement, a Peace Problem*, 34 Q. J. ECON. 567, 594 (1920) (stating that two-thirds of all requisitioned ships were in direct service of the Army and Navy). Crowell says that one purpose of the takeover was to prevent profiteering and that another was to promote necessary coordination. CROWELL, *supra* note 26, at 199. My hypothesis is: if the takeover would not have promoted coordination, the government would not have conducted the seizure solely to prevent profiteering.

71. HURLEY, *supra* note 35, at 43 (stating that owners of requisitioned ships became operators on behalf of the government; adding, without elaboration, that the government had to "provide for" the possibility of taking over a ship directly); CROWELL, *supra* note 26, at 199-200 (stating that original owners continued to handle ships' operations).

As to the seizure of the telecommunications industry, ideology rather than efficiency was the motivation. Yet this means little for our inquiry, since the companies gladly acceded to the seizure, lured by subsidies and other economic advantages.⁷² Again, existing management remained in charge.⁷³ Aside from these cases, seizures during World War I were very rare. For the entire nineteen months of hostilities, Baruch admitted he could not recall the seizure of "a single important industrial enterprise."⁷⁴ The War Department, for example, seized only four minor enterprises, each owning just one plant. In one of these cases, the War Department took over to prevent a labor dispute from shutting down production entirely, and Army officers ran the plant. In another case, the government took over the plant due to insolvency. In the last two cases, the government, breaking with the general pattern, took over for the sole reason that the firms were unwilling to produce at reasonable prices. In both these cases, however, the government simply hired another private firm to run the facility.⁷⁵

In World War II, the government followed the same principle that seizure was primarily an instrument to prevent stoppages or extreme downturns in production. The government used the seizure weapon rarely at first, taking over its first four firms in 1941 and another six in 1942.⁷⁶ Starting in 1943, however, labor relations worsened. In response, government personnel, with a few years of practice under their belts, apparently sharpened their emergency management techniques, conducting another fifty-four takeovers by the war's end.⁷⁷ Of the sixty-four total takeovers, fifty-seven were to prevent shutdowns due to labor disputes, five were to improve on incompetent management, and only one was the result of a price dispute.⁷⁸ The War Department, which

72. CHRISTOPHER N. MAY, *IN THE NAME OF WAR: JUDICIAL REVIEW AND THE WAR POWERS SINCE 1918*, at 32-33 (1989).

73. POST OFFICE DEPT., *GOVERNMENT CONTROL AND OPERATION OF TELEGRAPH, TELEPHONE AND MARINE CABLE SYSTEMS*, AUGUST 1, 1918, TO JULY 31, 1919, at 8-12 (1971).

74. Nye Comm. Report, *supra* note 61, at 114, *reprinted in* BARUCH, *supra* note 26, at 406.

75. JOHN H. OHLY, *INDUSTRIALISTS IN OLIVE DRAB: THE EMERGENCY OPERATION OF PRIVATE INDUSTRIES DURING WORLD WAR II*, at 10-12, 17 (2000) (This book is the edited version of a governmental report authored by one of the War Department attorneys in charge of plant seizures during World War II. *Id.* at xiv.). Crowell, in addition to citing several examples of the seizure of goods already in the stream of commerce, *supra* note 26, at 42-51, gives a few examples of firm seizures and of mandatory production orders, though none seems to involve a large firm. CROWELL, *supra* note 26, at 47, 156-57. Only one is clearly the result of a price dispute. *Id.* at 156-57. Crowell believes that seizures were scarce precisely because the threat of their use was effective in bringing contractors to terms. *Id.* at 46-47. In fact, however, the infrequency of seizures (at least in the case of large plants) is equally consistent with the notion that the government was afraid to carry them out. Indeed, Crowell admits that commandeering undermined government/contractor cooperation and lowered a firm's morale. *Id.* at 40.

76. OHLY, *supra* note 75, app. C.

77. *Id.* apps. B & C.

78. *Id.* apps. B & C.

conducted twice as many seizures as any other agency (all of them labor disputes), established a general policy of relying on current management to run a seized plant whenever possible, with the corporation legally acting as the agent of the government.⁷⁹ The War Department's official report on seizures stated that it was "very unusual" for management to refuse to cooperate or to force "direct government operations."⁸⁰ Besides, even when corporate officers did refuse to cooperate, this did not necessarily require long-term government management. During one takeover in 1941, management violated federal labor law and thereby forced the Army to put its own officers in charge of the plant as a stop-gap measure. However, since the company was in financial trouble, the War Department used the lure of government aid to get the board of directors to hire new management, who took over the plant after eight weeks of Army control.⁸¹ Overall, plant seizure in World War II proved a successful technique for the limited purpose of averting shutdowns and sub-par production.

To understand *Bethlehem*, however, we must appreciate that, early in the war, the government did not realize that seizure would prove successful even for this limited purpose. The War Department began planning its first seizure of the war in summer 1941. At that time, as one of its officials recalled, "[n]obody . . . had any clear idea about the technique of plant seizure or its feasibility." The people in charge were "only vaguely familiar" with World War I seizures. And worst of all, "Army organization for such a mission was wholly nonexistent."⁸²

In sum, the seizure power proved useless to the government in many crucial bargains.⁸³ In light of this, and of the high value that the government placed on victory and on lost time, many contractors stood to receive highly profitable deals.

B. RISK, INCENTIVES, AND CONTRACT STRUCTURE

The contractor's advantage did much to shape the outcome of

79. *Id.* at 34.

80. *Id.* at 282.

81. *Id.* at 40-53.

82. *Id.* at 21.

83. There were two additional bargaining weapons unique to the government, besides seizure. However, without the ability to seize and operate firms, neither was effective. First, the government controlled the allocation of supplies. If a contractor demanded too high a price, it could threaten to cut off the firm's inputs. See *supra* text accompanying note 26. But if the government could not operate the firm itself, such action merely deprived the public of the contractor's output, undermining the chief goal of maximum production. It would "work against the primary need of wartime." Nye Comm. Report, *supra* note 61, at 116; see also BRANDES, *supra* note 26, at 171. Second, the government could order a firm to accept and perform a contract at whatever price the government chose. This power was backed up only by the seizure power (not, for example, by a criminal penalty). Hence, "compulsory [production] orders . . . could have been of no greater effect than the commandeering power," which was no power at all. Nye Comm. Report, *supra* note 61, at 114.

wartime bargaining, but it was not the only factor. To fully understand the policy problem, we must also consider the enormity of wartime risk, the need for protection against it, and the way such protection interfered with efficient incentives.

In both conflicts, the government wanted to induce its contractors to fulfill several different goals. These included good product quality, minimization of monetary cost and of supplies used, and, in some cases, technological innovation.⁸⁴ For our purpose, the most important of the government's requirements was cost minimization. The government had to figure out a way to reward a contractor in proportion to the degree that it reduced cost. In an ordinary market, this was easy. Firms competed against each other to win a fixed-price contract. The government identified the lowest-cost firm through competitive bidding. The fixed price then held the firm to its promise.

In wartime, this did not work. As discussed above, competition was the first casualty of total war.⁸⁵ The next casualty was the fixed price, because war rendered cost extremely uncertain. Time and again, a firm found itself making a product that had never been made before.⁸⁶ Even if the product itself was not new, the firm producing it might have no experience with it.⁸⁷ Uncertainty compounded when specifications, suddenly overtaken by advancing technology or new priorities, changed in the middle of performance.⁸⁸ Even if the firm knew the product well, it often had to produce it at a volume⁸⁹ and speed never before attempted.⁹⁰ To do this, it might need to hire and train new workers in unprecedented numbers.⁹¹ Though their wages might be fixed or incorporated into an escalator clause,⁹² nobody could predict their level of efficiency or aggregate learning curve.⁹³ The prices of physical inputs likewise might be fixed or incorporated into an escalator clause, yet the amount of

84. The factors are taken from the Renegotiation Act of 1943. SMITH, *supra* note 25, at 380.

85. See *supra* text accompanying note 25.

86. JOHN PERRY MILLER, *PRICING OF MILITARY PROCUREMENTS* 134 (1949) (discussing new products); SMITH, *supra* note 25, at 281, 352 (quoting the Army procurement chief on new products).

87. MILLER, *supra* note 86, at 134; SMITH, *supra* note 25, at 353 (quoting Army procurement chief).

88. CROWELL, *supra* note 26, at 165–66; MILLER, *supra* note 86, at 128, 134; SMITH, *supra* note 25, at 281, 385.

89. SMITH, *supra* note 25, at 40, 353 (quoting Army procurement chief).

90. MILLER, *supra* note 86, at 134.

91. BRANDES, *supra* note 26, at 152.

92. On the use of escalator clauses for labor and supplies, see CROWELL, *supra* note 26, at 161–62; MILLER, *supra* note 86, at 135–37; SMITH, *supra* note 25, at 325–27. Miller and Smith note that the clauses were rendered partly or wholly obsolete by price controls and newer forms of contracting. MILLER, *supra* note 86, at 135–36; SMITH, *supra* note 25, at 327.

93. Transcript of Record at 1346, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9) (stating that labor efficiency in Bethlehem war plants, which was entirely unpredictable, would have a greater effect on cost than the wage rate); see BRANDES, *supra* note 26, at 152 (describing predominance of novice craftsmen on giant construction projects); SMITH, *supra* note 25, at 353 (quoting Army procurement chief on the training of new workers).

inputs wasted was hard to predict, since it depended on the firm's operations.⁹⁴ Transportation problems, such as the railroad crisis described above, added to the uncertainty.⁹⁵ What is more, firms went to all this effort to supply a military campaign that could end at any moment. War planners compiled a poor record of predicting when hostilities would cease.⁹⁶ And before 1945, peacetime demand for military products was very low.⁹⁷ In these circumstances, if peace came without warning, the firm, having converted its plant and given up its peacetime customer networks to make munitions that the government no longer wanted to buy, might well face ruin.⁹⁸

The uncertainty of war contracting exceeded anything imaginable in peacetime. The risks came in large numbers; each portended an enormous potential loss; and each turned on contingencies so arbitrary that probabilities could barely be assigned to them. If not set high enough to account for these risks, the price of a fixed-price contract could potentially bankrupt the firm.⁹⁹ Bankruptcy would harm not only the firm but also the government, which needed to keep its contractors in smooth operating condition throughout the conflict. Thus, when a contractor and the government entered a fixed-price contract, the price had to be high enough to account for these harrowing contingencies.¹⁰⁰

To avoid paying this huge risk premium, the government often assumed the risks of war itself, taking advantage of its unique ability to spread risk through taxation. In the words of the leading contracts scholar Friedrich Kessler, the "risk and uncertainty [of war] are so great that they can be borne only by government."¹⁰¹

94. Transcript of Record at 1345-46, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (stating that the value of spoiled material was unpredictable); BRANDES, *supra* note 26, at 153 (discussing waste of material due to inconsistent transportation, poor infrastructure, and lack of high-quality material supplied).

95. See *supra* text accompanying note 66.

96. BRANDES, *supra* note 26, at 164, 179 (World War I); WADDELL, *supra* note 31, at 83 (World War II).

97. BRANDES, *supra* note 26, at 214, 222 (stating that, in interwar years, less than two percent of Du Pont's gunpowder sales went to the military and less than one percent of Bethlehem's total sales did); Robert Higgs, *Introduction to ARMS, POLITICS, AND THE ECONOMY: HISTORICAL AND CONTEMPORARY PERSPECTIVES* xv, xv-xvi (Robert Higgs ed., 1990) (citing the spike in military demand from the late 1930s to 1940-1941).

98. On various business drawbacks to conversion during World War I, see BRANDES, *supra* note 26, at 222. On the steel industry's fear about overcapacity during World War I, see UROFSKY, *supra* note 28, at 185-86. On business drawbacks to conversion during World War II, see WADDELL, *supra* note 31, at 92 (quoting New Deal economist Robert Nathan). On firms' fears about overcapacity prior to World War II, see BRANDES, *supra* note 26, at 234; BRUCE CATTON, *THE WAR LORDS OF WASHINGTON* 46, 62 (1948); Higgs, *supra* note 21, at 172-77; Nathan W. Robertson, *Bottlenecks in Defense*, *NEW REPUBLIC*, Dec. 9, 1940, at 780, 780.

99. See SMITH, *supra* note 25, at 281.

100. *Id.* ("Fixed prices too low to cover costs would cripple war production . . .").

101. FRIEDRICH KESSLER & MALCOLM PITMAN SHARP, *CONTRACTS: CASES AND MATERIALS* 275 n.2 (1953). The government in World War II did use traditional fixed-price contracts, but only in very

In both wars, the most familiar way for the government to shoulder risk was to promise to pay the contractor's entire cost for the job. This led to the question of how to compensate the firm's owners. The government might have based the owners' compensation on the portion of invested capital or shareholder equity allocable to the contract. However, because these allocations were difficult to figure out,¹⁰² the government followed the more crude method of basing the owners' compensation on the cost expended on the job.

The contract might determine compensation as a percentage of that cost. This was a cost-plus-percentage-of-cost (CPPC) contract. To counteract the obvious incentive to raise cost, the compensation ratio might decrease as the cost increased.¹⁰³ But if the owners' investment remained fixed, this did not help: since the ratio usually did not fall to zero, the return on investment still rose as the cost increased ad infinitum. Because this contract unavoidably led to waste, Congress banned it after the First World War and never allowed it again.¹⁰⁴

Alternately, the contract might compensate the owners with a percentage of the initial estimated cost, regardless of the actual cost. This was a cost-plus-fixed-fee (CPFF) contract.¹⁰⁵ Under this scheme, if the owners' investment remained fixed, an increase or decrease in cost had no effect on the return. This feature improved on the CPPC contract, since it created no automatic incentive to raise cost. However, the contractor still might have some incentive to raise cost, for the actual cost often served as the basis for the estimate and fee in a future contract.¹⁰⁶ And, of course, the CPFF contract provided no incentive to lower cost. Yet another disadvantage was that cost uncertainty *ex ante* might give rise to an inflated estimate and fee.¹⁰⁷

Ultimately, both the CPPC and CPFF contracts (collectively known as cost-plus contracts) acquired reputations for waste and fraudulent cost reporting.¹⁰⁸ Despite this, the cost-plus contract (and in World War II, the

limited circumstances. MILLER, *supra* note 86, at 134.

102. MILLER, *supra* note 86, at 133 (describing a failed proposal to base rate of return on capital investment); SMITH, *supra* note 25, 386–88 (describing the difficulty of determining a contractor's net worth and allocating it by contract).

103. CROWELL, *supra* note 26, at 85, 184.

104. MILLER, *supra* note 86, at 124; CROWELL, *supra* note 26, at 32.

105. On this type of contract, see generally SMITH, *supra* note 25, at 280–310. The fee might also be calculated on estimated cost per unit of output. *Id.* at 289.

106. MILLER, *supra* note 86, at 129–30.

107. CROWELL, *supra* note 26, at 239–42; MILLER, *supra* note 86, at 132.

108. On waste, see BRANDES, *supra* note 26, at 150; CROWELL, *supra* note 26, at 39–40; SMITH, *supra* note 25, at 284–85; Charles E. Hughes, Report to the Attorney General on the Aircraft Inquiry 134 (Oct. 31, 1918) (unpublished report on file with the U.S. Naval Academy), *quoted in* United States v. Bethlehem Steel Corp., 315 U.S. 289, 306 (1942). On fraudulent and questionable cost reporting, see Nye Comm. Report, *supra* note 61, at 85, 90; BRANDES, *supra* note 26, at 153–54, 169–70. The government had statutory power to inspect all records related to war contracts. This was necessary not

CPFF contract specifically) remained the only workable option for the many projects whose costs were extremely uncertain.¹⁰⁹ Therefore, suppressing "grave misgivings,"¹¹⁰ the government allowed this contract to play a major role in mobilization. In World War II, for example, CPFF contracts accounted for forty-six percent of the value of military supply contracts over \$10 million in 1940-1941 and forty percent of that same category in 1944.¹¹¹

Ideally, the government wanted to combine the cost-plus contract's shield against risk with the fixed-price contract's incentive to reduce cost. This desire gave rise to several hybrid contracts in which the price formula depended partly on one or more fixed benchmarks. The most common version was a variation on the CPFF contract. There was a benchmark estimate. If the actual cost fell below the estimate, the contractor received some fraction of the savings as a bonus. If the actual cost exceeded the estimate, the contractor gave up some fraction of the excess, as a penalty. The ratio might vary depending on the size of the savings or excess.¹¹² Limiting the bonus or penalty to a mere fraction of the savings or excess gave the parties a cushion of risk protection. Ceilings or floors on bonuses and penalties served the same purpose.¹¹³ Alternately, the amount of savings or excess could be plugged into a formula that would increase or decrease the fixed fee by some ratio.¹¹⁴

However, due to the enormous cost uncertainty of wartime, basing prices on fixed benchmarks, even with the various cushions described above, could still impose grave risk on one or both parties. The government in World War I made such contracts shortly after the start of mobilization, before good cost data was available. This resulted in scandals involving erroneous estimates and eye-popping profits, not the least of which was the *Bethlehem* case.¹¹⁵ By World War II, prudence set in. The armed services realized that such incentive contracts proved useful only when "sufficient prior experience" with the product at issue allowed for an estimate that was better than a wild guess.¹¹⁶ In light of this, the Navy did not use this type of contract with any frequency until

only to police cost reporting in cost-plus contracts, but also for the administration of other types of contracts, discussed in the remainder of this section. SMITH, *supra* note 25, at 312.

109. MILLER, *supra* note 86, at 126-28.

110. *Id.* at 129.

111. *See id.* at 127 tbl.1. The government's effort to rid itself of the CPFF contract did not gain traction until the very end of the war, when it began converting CPFF contracts to contracts with mid-performance price-adjustment clauses. SMITH, *supra* note 25, at 302-10, 331-32. On those contracts, see *infra* text accompanying notes 119-25.

112. MILLER, *supra* note 86, at 145.

113. *E.g., id.*

114. *E.g., id.* at 131.

115. For cases besides that of *Bethlehem*, see BRANDES, *supra* note 26, at 162, 186; CROWELL, *supra* note 26, at 244.

116. MILLER, *supra* note 86, at 146.

three and one-half years after the beginning of mobilization.¹¹⁷ The Army waited even longer.¹¹⁸

This last point exemplifies a larger principle: cost uncertainty usually decreased over time. It decreased generally over the course of the war, for various reasons.¹¹⁹ And it decreased over the life of a given contract, by definition. Thus, if the determination of benchmarks—or even of an actual fixed price—could be pushed forward in time, to a point after performance got underway, the determination could be made with better information. Such information might come from the performance itself, from other jobs completed by the same firm or other firms, or from the known outcome of contingencies that had been shrouded in uncertainty when performance began.¹²⁰ Also, if the parties knew that a more accurate price could be chosen at some later time, they would not need to commit to a high price at the outset to account for contingencies.¹²¹ Further, if the eventual cost differed from what was expected, one could distinguish between a difference that resulted from factors within the contractor's control and one that did not, allowing a higher or lower price in the case of the latter but not the former.¹²² In this way, the contractor received a reward for reducing cost, a penalty for letting cost increase, and protection from any change it could not control.

This strategy of mid-performance price adjustment played almost no role in the First World War.¹²³ In the Second World War, however, the

117. *Id.* at 144.

118. *Id.*; SMITH, *supra* note 25, at 337–38.

119. See MILLER, *supra* note 86, at 134 (stating that early in World War II more products were new or unfamiliar to their makers and that specifications changed more); SMITH, *supra* note 25, at 279 (stating that cost and price analysis improved as World War II progressed), 314 (noting that “required cost breakdowns” of contractors became “increasingly specific”), 384 (noting that risk lessened from the rearmament period to the actual war, since conversion was completed and novel products became more familiar).

120. For a treatment of price and cost analysis applicable to price-adjustment clause contracts and other contracts, see generally SMITH, *supra* note 25, at 313–25.

121. *Id.* at 332 (stating that in price adjustment contracts, “contingency allowances in price to cover external cost changes were to be substantially eliminated”).

122. MILLER, *supra* note 86, at 140; SMITH, *supra* note 25, at 277–78.

123. CROWELL, *supra* note 26, at 36 (stating that the great majority of World War I contracts were CPPC, CPFF, or fixed-price); Memorandum on Behalf of Bethlehem Shipbuilding Corporation, Ltd., Regarding the Claim that Its Contracts with United States Shipping Board Emergency Fleet Corporation on the Cost Plus Fixed Fee Plus Percentage of Savings Basis Were Invalid at 7–8 (Apr. 23, 1924) [hereinafter Memorandum on Behalf of Bethlehem] (on file under Enclosures, Straight Numerical Files 226416, General Records of the Department of Justice, Record Group 60, National Archives, College Park, MD) [Files relating to the *Bethlehem* case are collected under Number 226416 in the Straight Numerical Files of the General Records of the Department of Justice. That case file is hereinafter cited as DOJ-NA. It is divided into eight numbered sections, plus another section called “Enclosures.” Those sections will be indicated throughout.] (listing contract types in World War I as CPPC, CPFF, fixed-price, and savings). Note that Crowell, in his entire survey of World War I contracts, mentions price-adjustment schemes only twice, once in an actual contract, CROWELL, *supra* note 26, at 245, and again in the case of prices revised ex post in an improvised way, under political

government made extensive use of voluntary price-adjustment provisions.¹²⁴ The details of the arrangement varied according to the situation: there could be any number of adjustments; they might occur on a fixed schedule or ad hoc; they might cover the entire contract or only the remainder of performance; they might be limited as to amount or direction; and the factors to be used in deciding adjustments might be defined at varying levels of specificity.¹²⁵

While the armed services frequently provided for the voluntary adjustment of price during performance, Congress went further. In April 1942, five months after Pearl Harbor and two years after the beginning of rearmament, it passed the landmark Renegotiation Act, granting to the services unilateral power to change the price of any contract after performance, whenever they considered the profits "excessive."¹²⁶ When administering the Renegotiation Act, the services used, and Congress later enumerated, several factors to decide what profit a contractor deserved. The factors included product quality, the contractor's conversion of plant, its shareholder equity, technological innovation, assumption of risk, and—most important—cost reduction.¹²⁷ The "theory" of the statute "was that allowable profits should be determined in such a way as to reward the contractor who in the light of all circumstances controlled his costs well and sought to use labor and materials efficiently."¹²⁸

Hence, every judgment under the Renegotiation Act had to be made *relative to* the contractor's unique constraints and capabilities.¹²⁹ For example, if one contractor produced a certain level of output with a more advanced plant and another produced the same level with a less advanced one, the latter deserved a higher profit, other things being equal.¹³⁰ One could never know the exact constraints and capabilities of every contractor, and the task, if taken literally, "called for omniscience."¹³¹ Renegotiators did their best with fragmentary evidence and made somewhat intuitive determinations.¹³² The enormity of their workload and the scarcity of time and facilities added to the challenge.¹³³

pressure, *id.* at 237-42.

124. On voluntariness, see SMITH, *supra* note 25, at 330, 332. The government had various methods, including compulsory orders, by which to persuade contractors to agree. On their effectiveness, see *supra* Part I.A.

125. MILLER, *supra* note 86, at 139-40, 141-44 tbl.II; see SMITH, *supra* note 25, at 328-37.

126. SMITH, *supra* note 25, at 354.

127. *Id.* at 357, 380.

128. MILLER, *supra* note 86, at 181.

129. *Id.* at 182; see SMITH, *supra* note 25, at 381.

130. MILLER, *supra* note 86, at 181-82.

131. SMITH, *supra* note 25, at 380.

132. MILLER, *supra* note 86, at 183.

133. SMITH, *supra* note 25, at 384.

Given that the Renegotiation Act was a second-best solution, how well did it work? The critics' main complaint was that renegotiation officials failed to recognize improved efficiency when they saw it.¹³⁴ Instead, the critics alleged, officials relied unconsciously on two crutches. First, they sometimes tended to reduce all contractors' pre-adjustment profits on a single graduated basis, failing to sort out the efficient contractors from the inefficient ones.¹³⁵ Second, officials had a narrow range of profit-to-cost ratios that they considered appropriate, and they tended to set profit levels to fit that range, regardless of contractor efficiency. This last crutch, lamented the critics, effectively duplicated the infamous CPPC contract, discouraging cost reduction.¹³⁶ (Similar dangers cast a shadow over the administration of mid-performance price-adjustment provisions.¹³⁷)

Defenders of renegotiation responded that these charges were exaggerated or mistaken. Although contractors' profits when measured as a percentage of cost did indeed fall in a relatively narrow range, those same profits when measured in proportion to shareholder equity exhibited much wider variation.¹³⁸ As for the charge that officials simply reduced initial profits on a single graduated basis, defenders of renegotiation noted that initial profits themselves fell dramatically as the renegotiation program matured. This reduction in initial profits, they argued, occurred in large part because the looming presence of renegotiation at the end of performance meant that officers were more aggressive in proposing, and contractors were more willing to accept, lower initial prices and downward mid-performance price adjustments that eliminated charges for contingencies. The timing of these adjustments early in the life of the contract gave the contractor a more immediate and better-defined incentive to cut cost. Further, the more the contractor was willing to assume downside risk in this pricing process, the stronger its incentive to reduce cost: the official therefore gave contractors bigger rewards the more downside risk they took on. In light of all this, not only did the Renegotiation Act directly expropriate profits *ex post*, but the Act's very existence indirectly reduced profits *and costs ex ante*.¹³⁹ Renegotiation was meant to simulate an ordinary market, in

134. MILLER, *supra* note 86, at 181–82.

135. SMITH, *supra* note 25, at 384–85.

136. MILLER, *supra* note 86, at 181–82.

137. See *id.* at 140 (stating that any failure to distinguish between causes of cost changes that are within or not within the contractor's control causes the price-adjustment contract to operate like a CPPC contract).

138. SMITH, *supra* note 25, at 387.

139. On the relation between renegotiation and advance close pricing, see *id.* at 393–94 (stating that the “existence of the renegotiation statute was probably the most compelling single influence behind the close-pricing efforts of the procuring agencies” and that “renegotiation was a perpetual reminder to contracting officers [and] contractors of the importance and necessity of close pricing”).

which cutting one's costs and risking one's investment led, on average, to bigger profits.

C. RE-PRICING AFTER PERFORMANCE AS A CHECK ON THE CONTRACTOR'S BARGAINING POWER

Let us now return to the issue of bargaining power. Considering the government's voracious and relatively sudden demand and the favorable bargaining position of numerous contractors, the latter certainly extracted substantial pure rents, i.e., profits greater than necessary to induce the contractor, in the long run, to keep its assets in their current employment at their current efficiency.¹⁴⁰ These rents could come in any number of forms, including inflated prices in fixed-price contracts; fees or bonuses based on inflated estimates in CPFF contracts; or fraudulently reported costs in cost-plus contracts. Such rents posed many dangers. By definition, they contributed less to the war than if spent elsewhere. They caused prices to go out of phase with the actual resources necessary to production, undermining efficient allocation.¹⁴¹ They gave a contractor the financial freedom to engage in certain practices—such as hoarding supplies or enticing away the workers of other contractors—that helped the firm individually while hurting the war effort as a whole.¹⁴² Perhaps most important, windfall profits poisoned national morale. It was galling for millions of draftees to endure hardship and risk their lives for low wages while businessmen safe at home grew fat on money they did not earn. Such resentment exemplified a larger issue: total war entailed massive economic disruption and redistribution, and under such conditions, if too many people sensed that others were benefiting unfairly, effective prosecution of war became politically impossible. Roosevelt and his advisers understood the problem, and they thought it crucial to convince all social groups that the sacrifices of war were being distributed fairly.¹⁴³

On the importance of advance close pricing to cost-cutting, see *id.* at 330–36 (stating that advance close pricing was the “cornerstone of the Army’s matured pricing philosophy”). Critics complained that the safety net of renegotiation gave an official less incentive to set the initial contract price as accurately as possible given all available information. MILLER, *supra* note 86, at 181. On the contractor’s assumption of risk and the rewards for it, see SMITH, *supra* note 25, at 382–86.

140. Some high profits represented reasonable risk premiums, even if the government was improvident in how it allocated risk. See MILLER, *supra* note 86, at 179 (stating that war profits may arise from simple uncertainty). Some, if earned after mid-1940 and before Pearl Harbor, served the legitimate purpose of inducing firms to convert to military production before the government had wartime power to force them to. SMITH, *supra* note 25, at 275–76.

141. See SMITH, *supra* note 25, at 324.

142. *Id.* at 276; see also BRANDES, *supra* note 26, at 153 (giving an example of labor hoarding).

143. For the concerns of the Roosevelt administration, see Mark H. Leff, *The Politics of Sacrifice on the American Home Front in World War II*, 77 J. AM. HIST. 1296, 1299–302 (1991). For a general treatment of war profits and public attitudes toward them during the World Wars, see BRANDES, *supra* note 26, at 141–265. On resentment of inequality of sacrifice, see *Hearings Before the Special*

The government in World War I made no attempt to reform the law of contracts to redress the evil of wartime rents.¹⁴⁴ The inaction stemmed partly from reliance on the tax system to solve the problem, when in fact taxation was structurally incapable of doing this very effectively.¹⁴⁵ The failure did serious damage. While the inefficiencies cannot be measured, there is every reason to think they were widespread. On the political side, the perception of windfall gains from the war—reputed to have created 23,000 new millionaires—contributed powerfully to the bitter and paranoid isolationism of the interwar years, which left the United States dangerously unprepared to meet the rising threat of the Axis.¹⁴⁶

During rearmament in 1940–1941, Congress acted just as permissively as it had during the previous war,¹⁴⁷ but after Pearl Harbor, it became more proactive. First, it capped the profit on every CPFF contract at seven percent of estimated cost, with the cap including both the fee and bonuses.¹⁴⁸ Second, it passed the Renegotiation Act. Although, as noted in the preceding discussion, the Act was largely a measure to protect against risk while encouraging cost reduction, it also

Committee Investigating the Munitions Industry, United States Senate, 74th Cong. 5734 (1936) (dialogue between Sen. Clark and Eugene Grace) [hereinafter *Nye Hearings*]; John T. Flynn, *Why Should Youth Pay the War Bill?*, NEW REPUBLIC, Sept. 23, 1940, at 416; Editorial, *Mr. Morgenthau's Bombshell*, NEW REPUBLIC, Oct. 6, 1941, at 423, 424. On war profits and morale, see Hensel & McClung, *supra* note 28, at 188–89. On low Army wages in World War I, see BRANDES, *supra* note 26, at 152.

144. See generally CROWELL, *supra* note 26; R. PRESTON SHEALEY, *THE LAW OF GOVERNMENT CONTRACTS* (2d ed. 1927) [hereinafter SHEALEY 2d ed.]; R. PRESTON SHEALEY, *THE LAW OF GOVERNMENT CONTRACTS* (1919) [hereinafter SHEALEY 1st ed.]. For the general rule that the federal government was bound by the common law, see *Cooke v. United States*, 91 U.S. 389, 396 (1875).

145. "The Government in World War I ultimately relied almost entirely upon the excess-profits tax to eliminate excessive profits." Hensel & McClung, *supra* note 28, at 196. Also, contracting officers frequently assumed that tax would be sufficient to recover any excess profits. Transcript of Record at 1346, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (No. 8 & 9) (Testimony of Radford); PAUL MAXWELL ZEIS, *AMERICAN SHIPPING POLICY* 104 (1938). The tax reached a certain percent of all profit above a certain rate of return on invested capital. Hensel & McClung, *supra* note 28, at 196–98. This gave rise to several perverse results. Because the tax rate never reached one hundred percent, it spurred contractors to demand even higher profit margins than they would have without the tax, defeating the purpose of profit limitation and worsening inflation. BARUCH, *supra* note 26, at 415; Hensel & McClung, *supra* note 28, at 198; SMITH, *supra* note 25, at 393. It also led contractors to make self-dealing payments that were classified as cost, rather than profit, to avoid the tax. BRANDES, *supra* note 26, at 172. It could not be used to reduce prices charged to the government, since its rigidity precluded any reward for efficiency. Hensel & McClung, *supra* note 28, at 214–17. According to a wide array of Congressional investigations and executive officials, taxation could not be relied upon to hold down the profits from defense contracts and their cost to the government. *Id.* at 192, 197, 198–99, 215; SMITH, *supra* note 25, at 393. The tax succeeded, however, as a producer of revenue. Hensel & McClung, *supra* note 28, at 198, 215.

146. SMITH, *supra* note 25, at 351 (recounting the widespread notion that World War I created 23,000 millionaires), 394–96 (stating that World War I "yielded widespread exorbitant profits and resulted in a protracted era of resentment and controversy throughout the interwar period," facilitating "the short-sighted policy of disarmament which left the United States woefully unprepared" for World War II). For a general narrative, see BRANDES, *supra* note 26, at 141–225.

147. See *infra* text accompanying notes 433–45.

148. MILLER, *supra* note 86, at 129, 144; SMITH, *supra* note 25, at 367 n.43.

had important implications for bargaining power.

One way to prevent wartime rent extraction was for the legal system to mandate that the government could not bind itself to a particular price until some later time, when the moment of necessity had passed. The duress theory in the *Bethlehem* case would have done exactly this, conferring on the government an inalienable right to seek re-pricing of every important war contract after performance. The Renegotiation Act did not go quite as far in limiting the government's freedom of contract, for it granted the armed services discretion to exempt all or part of a contract from renegotiation whenever "the provisions of the contract" were "otherwise adequate to prevent excessive profits."¹⁴⁹ This condition seems to have kept officials from signing away the right to renegotiate. The Army imposed "substantial restrictions" on granting exemptions for most of the war and "never widely" made such grants. The Navy almost never made them.¹⁵⁰ According to one leading study of wartime procurement, the Renegotiation Act limited the "unconscionable profits" that arose when a "willful minority" of contractors tried to take advantage of the government.¹⁵¹

When the law limits a party's freedom of contract, as the Renegotiation Act effectively did, critics object that such a limitation makes other parties reluctant to deal with the party so restrained. But in total war, this objection lacks force, since, as noted above, the government could shut down any firm that refused to deal with it. The expected return from shutdown would typically be less than the expected return from contracting at a renegotiable price, so most contractors would still deal.¹⁵²

Hence, the Renegotiation Act helped lower the threat that wartime rents posed to national morale and possibly their threat to efficient mobilization, as well.¹⁵³ At the time, however, renegotiation was

149. Renegotiation Act, ch. 619, 56 Stat. 982, § 801(c)(i)(2)(iii) (1942).

150. MILLER, *supra* note 86, at 185 & n.49; SMITH, *supra* note 25, at 333, 336-37. In fact, experts believed that prudent granting of more exemptions would have raised efficiency. MILLER, *supra* note 86, at 185-86; SMITH, *supra* note 25, at 333-34.

151. MILLER, *supra* note 86, at 187. Miller presents the Act as a response to the Truman Committee's call for "some form of substantial review" to keep contractors "from taking advantage of the Government." *Id.* at 170.

152. During peacetime rearmament, as in 1940-1941, when the government did not have the power to shut down firms, high profits might fulfill the legitimate purpose of encouraging conversion. SMITH, *supra* note 25, at 275-76. Hence, a policy of renegotiation (or, for that matter, adoption of the government's duress theory in *Bethlehem*) had much greater disadvantage for the government during peacetime rearmament than during actual war.

153. On renegotiation's benefit to morale, see MILLER, *supra* note 86, at 179; SMITH, *supra* note 25, at 357, 396. On efficiency, see *supra* text accompanying notes 119-22, 138-39. Of course, World War II was still quite profitable to U.S. industry compared to peacetime. SMITH, *supra* note 25, at 396. For a general argument that the U.S. government in World War II failed to prevent "profiteering" (but with no specific treatment of renegotiation), see BRANDES, *supra* note 26, at 262-65.

precarious from a political standpoint. The government had not considered anything like it in World War I. During rearmament in 1940–1941, the business lobby gutted even the relatively ineffective taxes imposed on defense contracts;¹⁵⁴ more thorough reforms like renegotiation did not even appear on the horizon. And even while the Renegotiation Act was in force, business lobbied hard for its repeal, which seemed quite possible in early 1944.¹⁵⁵

This explains the importance of the government's theory of duress in the *Bethlehem* case. It served as the Roosevelt administration's fallback at a time when Congress seemed unlikely to pass reform of its own.¹⁵⁶ Had the duress theory been adopted, it would have entailed some of the same dangers as renegotiation, particularly if the courts simply chose a "normal" profit-to-cost ratio without due consideration of the contractor's efficiency, its assumption of risk, and other factors. To its credit, the administration acknowledged that courts needed to consider such factors in deciding the profit level.¹⁵⁷ Even so, the expensive, piecemeal process of adversary litigation could not possibly decide fair and efficient prices with the precision or speed of the expert bureaucracy that administered the Renegotiation Act.¹⁵⁸ Still, the prospect of duress litigation would mean that prices were to become final only when the government was in a better bargaining position. Like renegotiation, this prospect might persuade contractors to accept, in the first place, prices that eliminated charges for contingencies and were therefore more accurate. That, in turn, might promote efficiency. All in all, litigation under the *Bethlehem* theory would have been an imperfect imitation of renegotiation, which was itself an imperfect cure for the pathologies of war contracting. Though not ideal, it was likely better than nothing. For New Dealers, it seemed the only hope.

II. THE BARGAIN WITH BETHLEHEM

A. THE GOVERNMENT'S DESPERATE SITUATION

On the eve of World War I, U.S. merchant shipping was a disaster waiting to happen. The nation's shipbuilding industry had endured several decades of poor management and high labor costs, with none of the subsidies that European governments lavished on their respective

154. See *infra* text accompanying notes 431–43.

155. SMITH, *supra* note 25, at 334, 354, 357.

156. See *infra* Part IV.C, especially text accompanying notes 430–55, and Part IV.E, especially text accompanying notes 569–75.

157. See *infra* text accompanying notes 389–91.

158. Many renegotiation officials were drawn from industry and finance, sometimes the elite thereof. MILLER, *supra* note 86, at 180; Hult Lawrence Wilson, *Renegotiation: Pro and Con*, 10 LAW & CONTEMP. PROBS. 376, 378 (1944). On the large nationwide bureaucracy and its procedures, see SMITH, *supra* note 25, at 358–61.

fleets. As a result, less than one-tenth of American exports traveled under U.S. flag in 1913.¹⁵⁹ The wartime disruption of European shipping cut off U.S. exporters. In response, Congress in September 1916 created a Shipping Board and authorized it to charter public corporations to buy new merchant vessels. But the Board did not assemble until March 1917.¹⁶⁰

Within weeks, Congress declared war. A fleet so small that it could not handle the nation's ordinary peacetime commerce suddenly needed to transport and supply an army of two million men. It would take time—something the Allies did not have. That winter, the Bolsheviks took Russia out of the war, allowing Germany to transfer its troops to the Western front.¹⁶¹ They now outnumbered the French and British, who literally had no young men left to conscript.¹⁶² The Allies could not hang on much longer without American help.¹⁶³ U.S. troops were coming ashore with dangerously low supplies; if this continued, warned a top general, catastrophe loomed.¹⁶⁴ By the following summer, the Army had so few horses and motors that one of its divisions literally could not move.¹⁶⁵ It had so little ammunition that generals told their subordinates to “economize” when firing at the enemy.¹⁶⁶

Shipping was the bottleneck, one made narrower by German submarines, which were sinking Allied vessels as fast as they could be churned out.¹⁶⁷ The U.S. government contemplated with horror that “the war might be lost for lack of cargo-ships.”¹⁶⁸ The Shipping Board made a frenzied effort to increase the nation's tonnage. It chartered neutral vessels, borrowed British ones, and sent coastal ships on ocean

159. Gail Radford, *William Gibbs McAdoo, the Emergency Fleet Corporation, and the Origins of the Public-Authority Model of Government Action*, 11 J. POL'Y HIST. 59, 64 (1999).

160. DARRELL HEVENOR SMITH & PAUL V. BETTERS, *THE UNITED STATES SHIPPING BOARD: ITS HISTORY, ACTIVITIES, AND ORGANIZATION* 1-8 (1931).

161. HARRIES, *supra* note 35, at 208.

162. *Id.*

163. *See id.*

164. *See* CUFF, *supra* note 41, at 135.

165. HARRIES, *supra* note 35, at 392.

166. *Id.* at 393.

167. P.H. Douglas & F.E. Wolfe, *Labor Administration in the Shipbuilding Industry During War Time* (pts. 1 & 2), 27 J. POL. ECON. 145, 362, 145 n.1 (1919).

168. HURLEY, *supra* note 35, at 132. Kennedy notes that the United States had ships on Latin American trade routes which it refused to divert to the Atlantic, all in an effort to improve the U.S. commercial position vis-à-vis Britain. KENNEDY, *supra* note 50, at 326-29. One might argue that this refusal undercuts the notion that the United States was truly desperate for merchant ships to avoid military defeat. However, the United States' objective in entering the war was not merely to defeat Germany, but to win a liberal peace against the imperialist victors Britain and France. Wilson said: “At the peace conference the economic power of the United States must be entirely unrestricted, as this force in our hands may be of powerful assistance in enabling us to secure the acceptance of our views.” *Id.* at 336. For a sense of what Wilson was up against, consider the hardball tactics used by Britain and France against the United States. *See* HARRIES, *supra* note 35, at 408-14, 426-29.

voyages.¹⁶⁹ Luxury liners were converted to transports.¹⁷⁰

Most important, the Board created the Emergency Fleet Corporation (EFC) to contract for the construction of new ships. The EFC spent \$2.6 billion of public money in 1917–1918.¹⁷¹ This budget placed it on a par with the Army and Navy.¹⁷² Its first big purchase occurred in August 1917, when it requisitioned all major ships then under construction in what few private shipyards the nation had, signing contracts with the yards to finish the ships for the government.¹⁷³ Further, the EFC made additional contracts with these yards that took up their remaining capacity, with the exception of Navy orders, for the indefinite future.¹⁷⁴

Still unable to meet the demand, the EFC contracted with private firms to construct and operate new shipyards.¹⁷⁵ Many of the contracting firms were “mushrooms,” either new companies altogether, or new to shipbuilding.¹⁷⁶ Although the new yards sprang up with unprecedented

169. Day, *supra* note 70, at 587 (neutral ships); ZEIS, *supra* note 145, at 108 (British and coastal ships).

170. BRANDES, *supra* note 26, at 167.

171. Day, *supra* note 70, at 583 n.1.

172. UROFSKY, *supra* note 28, at 203 (calling the EFC, Army, and Navy the “three great agencies” from the perspective of the steel industry).

173. See Day, *supra* note 70, at 581–82 (describing the requisition); A.B. Wolfe, *Intensive Industrial Training Under Government Auspices in Wartime*, 27 J. POL. ECON. 725, 726 (1919) (stating that the nation had “but a handful of well-equipped yards” and “few experienced managers”). On the formation of new agreements after requisition, see Bill of Complaint at 1950, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9); Memorandum on Behalf of Bethlehem, *supra* note 123, at 2.

174. Brief for Respondents at 59, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9); Report of Special Master and Referee at 526–27, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) [hereinafter Master’s Report].

175. ZEIS, *supra* note 145, at 106 (referring to the “construction companies” that built the shipyards), 113–14 (stating that only private firms, not the government, built ships).

176. *Id.* at 102, 104–05; HURLEY, *supra* note 35, at 61–62, 186. Zeis argues that the EFC had no less experience and administrative capacity than the “mushroom” firms, meaning that the agency itself could have taken over the construction of new yards and of ships therein. ZEIS, *supra* note 145, at 104. (The failure to do so, says Zeis, suggests that the EFC was captured by the industry. *Id.* at 114.) This analysis may be right. But it does not apply to old line firms like Bethlehem, whose organization at the outset was far better established than that of the EFC and the mushrooms. Indeed, Zeis concedes that the government was, to some extent, “forced . . . to rely on private shipping officials who might reasonably be expected to look after their own interests[.]” *Id.* at 114. On a related point, it should be noted that the EFC itself, while it never directly built or ran the yards, did acquire more administrative capacity than most wartime agencies. HURLEY, *supra* note 35, at 143. Its executive and clerical staff in spring 1918 totalled approximately 2,400. *Id.* It designed and inspected ships. Bernard Mergen, *The Government as Manager: Emergency Fleet Shipbuilding, 1917–1919*, in *BUSINESS AND ITS ENVIRONMENT: ESSAYS FOR THOMAS C. COCHRAN* 49, 54–55 (Harold Issadore Sharlin ed., 1983). It acted as a central purchasing unit for the yards. HURLEY, *supra* note 35, at 154; Douglas & Wolfe, *supra* note 167, pt. 2 at 376. It established a training program in which experienced workers learned to be instructors. *Id.* at 378. It also sought to govern the allocation of workers between yards, though this operation was only begun when the war ended. *Id.* at 376. Further, the EFC trained sixty employment managers, though it placed only seventeen of them in the yards. Mergen, *supra*, at 73. The EFC likely found it more worthwhile to take on these functions than did other agencies precisely because so many

speed,¹⁷⁷ they were “on the whole hastily and poorly constructed” and operated inefficiently in comparison to the old line yards that had been in business since before 1917.¹⁷⁸ Of the record-breaking tonnage delivered to the EFC during wartime,¹⁷⁹ about three-quarters came from contracts arising from requisitions in the old line yards, even though the construction of most of these ships had not even begun at the time of requisition.¹⁸⁰ The remaining one-quarter came in part from additional contracts with the old line yards.¹⁸¹ The portion delivered by the new yards, then, did not exceed one-fourth of wartime output. The giant new yards at Hog Island, Bristol, and Newark—touted for their incredible size and innovative methods—delivered no more than a paltry total of three ships before the Armistice.¹⁸² Granted, these and other yards became productive in 1919 and would have massively increased wartime output had the conflict lasted longer,¹⁸³ though even then, the program as a whole could not have met the Army’s requirements on schedule.¹⁸⁴ Regardless, the few old line firms proved to be the EFC’s most reliable source under time pressure. Further, only these firms could reliably build more complex designs, such as tankers and troop ships.¹⁸⁵

of the firms with which it dealt were new and lacked preexisting administrative capacities. This did not mean that the EFC was a model of good organization. Its accounting system, for instance, was utterly disorganized; it took thousands of employees to straighten it out after the war. *The Shipping Board Scandal*, N.Y. TIMES, Nov. 13, 1920, at 10.

177. The number of ways for steel ships in American yards rose from 143 to 398 during the war. Day, *supra* note 70, at 583.

178. Douglas & Wolfe, *supra* note 167, pt. 1 at 149, 148.

179. For example, compare the 2.3 million tons delivered in nineteen months of war, Day, *supra* note 70, at 581–82, with the annual national average of 375,000 in the period 1900–1915, Douglas & Wolfe, *supra* note 167, pt. 1 at 147.

180. Day, *supra* note 70, at 581.

181. Apart from the requisitioned vessels, Bethlehem delivered three such contract ships to the EFC before the Armistice. Untitled Draft of Government District Court Brief at 127–28, enclosed with Letter from South Trimble, Jr., Solicitor, Dept. of Commerce, to the Attorney General (Sept. 8, 1936) (Section 4, DOJ-NA, *supra* note 123). At the time, much of the firm’s capacity was surely taken up with Navy orders. See Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. at 4, *United States v. Bethlehem Steel Corp.*, 23 F. Supp. 676 (E.D. Pa. 1938) (Nos. 3315 & 11970) (Enclosures, DOJ-NA, *supra* note 123) (stating that the firm built fifty percent of the Navy’s tonnage under war program).

182. By January 2, 1919, Bristol had delivered none, while Hog Island and Newark combined to deliver four. *Few Ships Completed*, N.Y. TIMES, Jan. 3, 1919, at 8. One of these was delivered by Hog Island in January 1919. *Id.* Between all three yards, therefore, no more than three ships could have been produced before the Armistice. For official boasting about these yards, see HURLEY, *supra* note 35, at 77.

183. Total output nationwide doubled from 1918 to 1919 as new yards became more productive, even though 1919 did not see the all-out effort of wartime. HURLEY, *supra* note 35, at 147–48.

184. *Id.* at 131.

185. Master’s Report, *supra* note 174, at 530 (quoting a letter from two experts stating that only “real shipbuilders” can build such ships “satisfactorily”).

B. NEGOTIATIONS WITH BETHLEHEM

The grand-daddy of the old line firms was Bethlehem, the largest shipbuilder in the world¹⁸⁶ and the bright spot in an otherwise bleak industry. In the years leading up to 1917, the company, under the superb leadership of Charles M. Schwab, had massively expanded its business in shipbuilding and elsewhere, proving itself a life-saver to the Allies.¹⁸⁷ During the nationwide requisition of August 1917, the EFC requisitioned all fifty ships then under construction in Bethlehem's yards and contracted with the firm to finish them.¹⁸⁸ In early December, the Navy signed a contract with Bethlehem for eighty-five destroyers. All told, Bethlehem would build half of the tonnage purchased by the Navy during the war.¹⁸⁹ Meanwhile, the EFC began negotiations to take up the rest of the firm's capacity with the construction of tankers and troop ships (both specialties of old line firms), as well as cargo vessels.¹⁹⁰ Between the requisitions and additional contracts, Bethlehem would build twenty percent of EFC tonnage.¹⁹¹ As if to underline the company's essential role, Schwab himself, at the personal urging of President Wilson, served as Director General of the EFC for the last seven months of the war (never, of course, dealing with his own firm).¹⁹²

Pricing presented a challenge. In peacetime, estimating the cost of a ship was a detailed technical process, but in total war, costs became unpredictable.¹⁹³ Granted, not every cause of wartime cost uncertainty applied in Bethlehem's case. Though the troop ships were novel, the tankers and cargo vessels followed familiar designs.¹⁹⁴ As for wages, the EFC had power to fix them, and the contract price could be escalated to

186. *Id.* at 526.

187. In the years leading up to the war, Schwab turned around the previously "defunct" Bethlehem by investing in innovative technologies and taking advantage of untried suppliers to lower transportation costs. UROFSKY, *supra* note 28, at 88–89. As war began in 1914, the Allies offered Bethlehem enormous contracts early and often. *Id.* at 90–91. These were so profitable that the firm could pay for a new plant largely out of earnings rather than debt. *Id.* at 185. The pay-off was immense: even after covering increased capacity, Bethlehem still paid dividends of thirty percent in 1916 and of two hundred percent in 1917. *Id.* at 92. By the time the United States entered the war, Bethlehem had produced \$246 million in war materiel for the European Allies, more than any American firm but one. *Id.* at 92.

188. On the number of ships and the "agreements" made to finish them, see Memorandum on Behalf of Bethlehem, *supra* note 123, at 2.

189. Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. at 4, United States v. Bethlehem Steel Corp., 23 F. Supp. 676 (E.D. Pa. 1938) (Nos. 3315 & 11970) (Enclosures, DOJ-NA, *supra* note 123).

190. Brief for Respondents at 59, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

191. Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. at 4, *Bethlehem*, 23 F. Supp. 676 (Nos. 3315 & 11970) (Enclosures, DOJ-NA, *supra* note 123).

192. Bill of Complaint at 1961–62, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9); ROBERT HESSEN, *STEEL TITAN: THE LIFE OF CHARLES M. SCHWAB* 264 (1975).

193. Master's Report, *supra* note 174, at 681.

194. *Id.* at 591–94.

reflect any increases.¹⁹⁵ But if the hourly rate was known, the number of worker-hours was anyone's guess. Bethlehem was operating at unprecedented volume, expanding its workforce from fifteen thousand to seventy thousand in under two years, at times hiring three thousand new workers per month.¹⁹⁶ These new hires usually had no experience.¹⁹⁷ Meanwhile, other yards were "poaching" the Bethlehem supervisors.¹⁹⁸ The tight labor market invited worker activism,¹⁹⁹ further threatening efficiency. Also, supplies could be cut off altogether if the Army needed them.²⁰⁰ Finally, the railway crisis was reaching its peak just as negotiations began, and nobody knew when fuel and material would arrive.²⁰¹ In this context, fine-tuned methods of cost estimation seemed downright silly. Bethlehem disbanded its cost estimation department altogether.²⁰²

These difficulties were evident to negotiators on both sides. Bethlehem was represented by its vice president, Joseph W. Powell.²⁰³ The EFC was represented by the manager of its contract division, G.S. Radford, and by the manager of its steel ship construction division, Admiral F.T. Bowles.²⁰⁴ The men, veterans of the shipbuilding industry, had known each other for years.²⁰⁵ At the opening of negotiations, on December 13, 1917, Powell informed Radford and Bowles that it was "impracticable to estimate within a reasonable percentage what would be the actual cost of construction."²⁰⁶ Radford acknowledged this to be a "fair statement."²⁰⁷

Despite the uncertainty, Radford and Bowles wanted Bethlehem to accept fixed-price contracts for the vessels. However, Powell knew that any fixed price satisfactory to Bethlehem would be so high that the government would prefer a cost-plus arrangement.²⁰⁸ With this in mind, Powell insisted on a CPFF contract with an incentive bonus.²⁰⁹ The contract called on the government to pay the entire cost, plus a fixed fee

195. *Id.* at 553.

196. Transcript of Record at 1347, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell).

197. *Id.* On strikes and labor unrest in shipbuilding during World War I, see HURLEY, *supra* note 35, at 186-95.

198. Transcript of Record at 1348, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell).

199. *Id.* at 1367 (stating unionism was rampant at one of Bethlehem's yards).

200. *Id.* at 1350.

201. *Id.*

202. Master's Report, *supra* note 174, at 681-82.

203. *Id.* at 575-76. The firm was also represented by its technical manager. *Id.*

204. *Id.* at 646, 686.

205. *Id.* at 643.

206. *Id.* at 530.

207. *Id.*

208. *Id.* at 628.

209. On hybrid CPFF/incentive contracts, see *supra* text accompanying notes 112-18.

of ten percent of the most accurate available estimate.²¹⁰ On top of that, the contract required the government to pay a “savings bonus” of one-half the difference between the estimate and the actual cost.²¹¹ For that reason, the arrangement was known as a “savings contract.” Bethlehem bore no downside risk: if costs exceeded the estimate, the government still paid them, plus the fixed fee.

With Powell insistent, Radford and Bowles accepted the savings clause. They then fought for what they considered a reasonable estimate. As negotiations stretched into January 1918, Powell somewhat lowered his estimate but went no further. With time at a premium,²¹² Radford and Bowles acquiesced on January 3, 1918, accepting Powell’s figures for seven contracts covering twenty-one tankers and eight cargo vessels.²¹³ The two men reported that Bethlehem had “insisted on comparatively high prices for these vessels.”²¹⁴ The final prices, they explained, did represent a “material reduction” from where the negotiations started, but they were still “not satisfactory to us.”²¹⁵ Nonetheless, Radford and Bowles felt that their acquiescence was justified: “Realizing that the Nation will need these vessels, we have been actuated by the belief that further delay in placing the contracts should be eliminated and we believe that we have made the best compromise possible under very difficult conditions.”²¹⁶

There was a disturbing wrinkle. Even as Powell dealt sharply with the shipbuilding experts Radford and Bowles, he also conducted negotiations—unknownst to them—with their superior, Charles Piez, who knew nothing about shipbuilding and relied on Powell for advice.²¹⁷ In fact, Powell wrote to Piez that Bethlehem would sign a contract at whatever price Piez chose—an offer that the innocent Piez never took up.²¹⁸ When the case reached the Supreme Court years later, Frankfurter

210. On the ten percent ratio, see Bill of Complaint at 1960, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

211. Master’s Report, *supra* note 174, at 521, 627.

212. Transcript of Record at 1616–18, 1620, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Radford).

213. Master’s Report, *supra* note 174, at 589.

214. *Id.* at 531.

215. *Id.*

216. *Id.* According to Radford’s later testimony, taken after Bowles’ death, Bowles cared about the prices, whereas Radford himself simply viewed it as his duty to finish the negotiations as soon as possible so as to get construction underway, regardless of price. Transcript of Record at 1614, 1616–18, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Radford).

217. On Piez’s ignorance and relationship to Powell, see Master’s Report, *supra* note 174, at 646.

218. On the offer, see *id.* at 588. On Radford and Bowles’ lack of knowledge, see *id.* at 588–89. Piez testified that the “natural thing” for him to do would have been to ask for another reduction in price, but he did not recall whether he did. *Id.* at 532–33. The Master’s findings do not suggest that Piez made any such request. See *id.* at 588–89. Note that, in testimony years later, Radford revealed that, even after he learned of Powell’s promise, he did not try to use it to get the prices reduced, for he felt it was not the “proper policy” of the EFC to dictate prices to contractors. Transcript of Record at 1623–25, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Radford). Powell claimed that his

derided this communication as Powell's "alibi letter."²¹⁹

Once made, the large January contracts served as models for all subsequent contracts for tankers and cargo vessels, executed at various times over the coming months.²²⁰ (Because the cost of troop ships was even more uncertain, the parties never attempted an incentive formula for them.)²²¹ Of the tankers and cargo vessels, Bethlehem had completed only three when the war suddenly ended.²²² At that moment, the firm and its fellow shipbuilders found themselves producing for an emergency that no longer existed. The government, then as now, possessed the power to cancel contracts. But it had reasons not to cancel. Some ships were so near completion that cancellation was not cost-effective.²²³ Also, firms had invested, and workers had retrained or relocated, in reliance on wartime shipbuilding. Cancellation would ruin businesses, slash jobs, and disrupt regional economies.²²⁴ Needless to say, firms and workers exerted political pressure against cancellation.²²⁵ Further, the Wilson administration viewed the shipbuilding program as a golden opportunity to dethrone Britain in postwar commerce.²²⁶ In light of these factors, the EFC cancelled only twenty-two percent of its wartime orders.²²⁷ Among the beneficiaries was Bethlehem.²²⁸ Its surviving contracts for tankers and cargo vessels, all under the savings formula, yielded forty of the former and twenty-six of the latter upon completion in 1920.²²⁹ Significantly, in the subsequent litigation, the government's failure to cancel never came up in court.²³⁰ Questions of law were decided as if the contracts had been

behavior was explained by the personal enmity between himself and Bowles, which arose from some previous, unrelated litigation. Transcript of Record at 1411-16, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell).

219. Letter from Justice Felix Frankfurter to Justice Stanley Reed (Jan. 29, 1942), *microformed on The Felix Frankfurter Papers*, Part I, Reel 4 (Univ. Publ'ns of Am.).

220. Brief for Petitioners at 11-12, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) [hereinafter Govt. S. Ct. Br.].

221. Memorandum on Behalf of Bethlehem, *supra* note 123, at 2.

222. Untitled Draft of Government District Court Brief, *supra* note 181, at 127-28.

223. Day, *supra* note 70, at 592.

224. HURLEY, *supra* note 35, at 252.

225. *Id.* at 252-54; ZEIS, *supra* note 145, at 109.

226. KENNEDY, *supra* note 50, at 301-05, 324-39.

227. Day, *supra* note 70, at 592.

228. Memorandum on Behalf of Bethlehem, *supra* note 123, at 2.

229. On date of delivery, see Untitled Draft of Government District Court Brief, *supra* note 181, at 128. For a list of the vessels of each type, see Master's Report, *supra* note 174, at 590. For another list, confirming that these constituted the entirety of the post-requisition contracts for tankers and cargo vessels made between Bethlehem and the EFC during the war, see Bill of Complaint at 1965-66, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9). The two lists differ in how many vessels were produced; I have assumed that the Master's Report is more trustworthy. Still, the complaint lists the same contract numbers for the types of vessels at issue as does the Master's Report, so we can rely on it to prove that all of the post-requisition contracts for tankers and cargo vessels were covered by the litigation.

230. Its only mention was in the Master's Report, *supra* note 174, at 541. Justice Black briefly

performed during war.

When the job was finished, the EFC began settling its accounts with Bethlehem. It took years. The EFC required thousands of employees to straighten out its poor accounting. Bethlehem's records were often incomplete or misleading. The firm refused to turn over documents.²³¹ After an arbitrator released his conclusions on certain interpretive disputes in March 1923, the final settlement seemed near. When Schwab strolled into a conference with EFC officials, he expected to be paid what the arbitrator recommended.²³² But the government attorneys had other ideas. The profit that Bethlehem stood to receive, they concluded, showed the agreements to be "unconscionable," "extortionate," and "hostile to the public interest."²³³ The savings contracts for the tankers and cargo vessels, insisted EFC officials, were invalid.²³⁴

C. THE QUESTION OF THE FAIRNESS OF THE EXCHANGE

Were EFC attorneys justified in their conclusion? Let us first consider the contract itself, regardless of its results. EFC negotiators shared Bethlehem's view that cost-plus contracts were demoralizing for executives and workers.²³⁵ They proposed a fixed-price contract but apparently did not offer a price high enough that Powell would consider it. According to Radford's testimony, the savings contract, which imitated the fixed-price contract to some degree, was "a very good form of contract" and "reasonable" — "in theory at least."²³⁶

However, the attractiveness of the actual agreement for the government depended on the accuracy of the estimate. If the estimate exceeded what the cost would have been under a plain CPFF contract, that excess would offset cost savings. If sufficiently inflated, the estimate might wipe out the cost savings altogether and even raise the total price above what it would have been under a plain CPFF arrangement. Unfortunately for the government, the parties decided the estimate only a few months into mobilization, at a time of the greatest cost uncertainty. (Recall that the armed services in World War II refused to commit

mentioned cancellation as part of an abstract policy discussion without specific reference to the actual case. *Bethlehem*, 315 U.S. at 309.

231. On EFC accounting, see *The Shipping Board Scandal*, *supra* note 176, at 10; on the rest, see Nye Comm. Report, *supra* note 61, at 87.

232. Memorandum on Behalf of Bethlehem, *supra* note 123, at 3–5.

233. Tilden Adamson, Special Examiner, Adamson Report on Bethlehem Claims 1 (Apr. 5, 1923) (Special Reports, File C, Drawer 1, Records Relating to the Bethlehem Steel Corporation, Records of the Department of Claims, Records of the U.S. Shipping Board, Record Group 32, National Archives, College Park, MD); C.G. Parker, General Counsel to the Shipping Board, et al., Report on the Claims of the Bethlehem Shipbuilding Corp. 4 (May 18, 1923) (same location as previous source).

234. Memorandum on Behalf of Bethlehem, *supra* note 123, at 4–5.

235. Transcript of Record at 1622, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Radford); see also Transcript of Record at 1338–39, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell).

236. Transcript of Record at 1623, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Radford).

themselves to such benchmarks until they had accumulated years of cost data.) Further, in the calculation of the estimate, the incentive mechanism required these giant uncertainties to be resolved in favor of Bethlehem, so as to give the firm a reasonable chance of winning the bonus.²³⁷

The goal of providing an incentive to reduce cost could have been achieved without exposing the government to the risk inherent in the Bethlehem contract's estimate. For instance, the difference between the estimate and the actual cost could have been plugged into a formula that would raise the fee by some ratio. Instead, Bethlehem enjoyed a direct claim on the difference itself. In addition, that claim (fifty percent) did not need to be so high. Percentages in Navy contracts during the same war, for example, ranged from fifty percent down to ten percent.²³⁸ Further, the parties could have retained the incentive effect while reducing the risk to the government if they had transferred some limited downside risk to Bethlehem, e.g., by devising a penalty for high cost that might somewhat reduce the contractor's very substantial fixed fee, as contracts did in World War II.²³⁹ Yet the ten percent fee remained inviolable. On its face, then, the contract greatly favored Bethlehem.

What profit did Bethlehem ultimately make? Summing all the contracts for tankers and cargo vessels under the savings formula, the estimated cost was about \$120 million. On this basis, Bethlehem automatically received a fixed profit of about ten percent, or about \$12 million. Significantly, the actual cost of the ships turned out to be just under \$93 million, less than the estimated cost by about \$27 million. This difference was classified as "savings," of which Bethlehem received half as a bonus. This came to around \$13 million, which, when added to the \$12 million fixed fee, yielded a total profit of about \$25 million. With extra charges added to the cost figure, the profit ended up at twenty-two percent of cost. That was very handsome for a contract with no risk of loss—indeed, with a guaranteed return targeted at ten percent.²⁴⁰

237. See Master's Report, *supra* note 174, at 552 (giving Piez's testimony on this point), 685 (in which the Master affirms that the estimate was to be liberal); Transcript of Record at 1623, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (same point). On Bethlehem's large allowances for future cost increases in its estimates, see *Bethlehem*, 315 U.S. at 321 (Frankfurter, J., dissenting). Powell stated that the estimate was to be one-third of the way from the bottom of the range of possible cost, Transcript of Record at 1445, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell), but this is not consistent with the other sources cited in this note.

238. CROWELL, *supra* note 26, at 145.

239. SMITH, *supra* note 25, at 337-38 (describing an incentive contract in which profit fell to zero at very high cost).

240. The figures differ slightly from one stage of litigation to the next. I have taken the dollar amounts from *United States v. Bethlehem Steel Corp.*, 113 F.2d 301, 304 (3d Cir. 1940), since no higher court gave a complete set of numbers. These numbers match the Master's Report, *supra* note 174, at 572. They yield a profit on cost of twenty-three percent. For reasons that are not explained, the Supreme Court used numbers that do not quite match, see *Bethlehem*, 315 U.S. at 292-93, 322-23, and

But was it necessarily a bad bargain for the government? To what degree did the large savings result from cost reduction, and to what extent from inflation of the estimate? A few calculations show that, for the government to be as well off under the savings contract as under a plain CPFF contract, Bethlehem had to cut the total cost by at least 12.6% from what it would have been under the latter format.²⁴¹ To say for certain whether Bethlehem succeeded is of course impossible, for we can never know what the cost would have been under a hypothetical contract. The evidence which the parties gathered on cost-cutting was indirect.²⁴² The courts' findings on the issue were not very specific.²⁴³

Even without specific evidence, the incentive to cut costs, nonexistent under a plain CPFF contract, gives reason to think Bethlehem did cut costs significantly. Powell, who, in addition to negotiating the contract, controlled operations, testified that the savings provision raised the morale of the firm, e.g., by causing the foremen to realize "that by saving money they were helping earn money for the company."²⁴⁴ There was at least some incentive compensation for some employees.²⁴⁵

Despite all this, there were competing reasons to doubt Bethlehem's cost-cutting. The firm was not using any new technology and had no hope of saving money on physical inputs; its only chance to cut costs was by improving worker efficiency.²⁴⁶ Powell testified that the firm did make

reached a profit of twenty-two percent. I have therefore given twenty-two percent as the profit.

241. Imagine that the savings bonus and the cost reduction exactly offset each other, i.e., that the bonus of \$13.38 million was exactly offset by a cost reduction of \$13.38 million. Recall that the actual cost, with the savings provision, turned out to be \$92.99 million. In this scenario, then, the savings provision would have motivated Bethlehem to reduce costs by \$13.38 million, down to \$92.99 million. This means that the cost *without* a savings provision (i.e., under a plain CPFF contract) *would have been* the sum of \$13.38 million and \$92.99 million, which comes to \$106.37 million. A reduction in cost from \$106.37 million to \$92.99 million is 12.58%.

242. See, for example, the government's misguided effort to glean Bethlehem's efforts to reduce cost by comparing costs on contracts early and late in the period of construction, with little attention to what the costs *would have been* without the incentive scheme. Govt. S. Ct. Br., *supra* note 220, at 24-31. Bethlehem's attorneys were no more illuminating on this point. Brief for Respondents at 33-52, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

243. Compare Master's Report, *supra* note 174, at 678 (stating there was "no evidence" that the savings clause reduced the cost of the ships, but not addressing whether there was any direct evidence it did not, and not basing the decision in any way on this finding), with *Bethlehem*, 113 F.2d at 307 (stating that "the record contains *some* evidence *tending* to show that the savings resulted, *in part at least*, from increased efficiency," but apparently not basing the decision on this finding) (emphasis added).

244. Transcript of Record at 1339-40, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell). On Powell's role, see *id.* at 1369.

245. Among several factors that Powell hoped would allow the firm to "improve on conditions" and "cut . . . costs," he included the practice of "offering special incentives to our supervisory force." *Id.* at 1438. But see *infra* note 248.

246. Transcript of Record at 1369, 1449-50, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell).

such an improvement, but he admitted that his assertion was "based on pure judgment only," not on "any study" nor "any facts that I could quote."²⁴⁷ Further, Powell was strangely equivocal when asked to talk specifically about incentive compensation for employees.²⁴⁸ Besides, even if one assumes that significant cost reductions did occur and that they resulted primarily from some sort of incentive compensation scheme, it seems absurd that the government had to pay Bethlehem a \$13 million inducement to implement such a scheme, considering the government would pick up all the costs of the scheme (e.g., the bonuses and the costs of administration) automatically. Finally, Radford and Bowles had stated *ex ante* that the estimate was inflated, and the large excess of the estimate over the actual cost seemed to confirm their assessment. In light of all this, it is at least understandable that the Shipping Board considered the contract a bad bargain.²⁴⁹

247. *Id.* at 1371. Any study of Bethlehem's management, had it been made, would have been of limited use, for the rapid increase in the firm's workforce inevitably sapped efficiency, meaning there was no constant benchmark against which to judge its effort to reduce costs. Brief for Respondents at 33-35, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

248. Bethlehem knew that it would not find out the size of the bonus, if any, until years after performance was complete, since there was certain to be a dispute between the firm and the EFC over cost allowances. Transcript of Record at 1332-33, 1445, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell). This would have made it difficult for any but long-term employees to participate directly in the bonus. That was important, considering that the firm would lay off most of its force once the war ended. Still, Bethlehem might implement incentive compensation during performance as part of an effort to win the bonus later on. *See supra* note 245. However, when asked directly whether the foremen, by "saving money" in their work and "earn[ing] money for the company" were "also helping earn money for themselves," Powell did not answer affirmatively. He replied: "That had nothing to do with that particular form of contract." He then added that "the incentive method we established with this form of contract should immediately give them [i.e., the foremen] an incentive to do the work as quickly and as well and as cheaply as it could be done." Transcript of Record at 1340, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell). This last statement appeared to be a recapitulation about how the savings provision in the EFC contract raised general morale, rather than a firm statement that Bethlehem was paying incentive compensation. And even if the firm were paying incentive compensation, it is possible that it would have done so anyway without the savings provision. After all, Bethlehem had instituted various measures to increase worker efficiency before making that contract. Govt. S. Ct. Br., *supra* note 220, at 29-30. Also, it should be noted that the most serious problem with labor efficiency appears not to have been motivation of workers on the job, but rather massive turnover due to competition between shipyards. On the centrality of the turnover problem, see Transcript of Record at 1367, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell). This problem was later resolved by fixing wages across the shipyards. *Id.* at 1432-33.

249. The notion of a good-faith cost-cutting effort is also undermined by Bethlehem's cavalier treatment of costs. Because the government paid all costs, the contractor had every reason to stretch the definition of cost to include self-dealing payments. Indeed, Bethlehem did just that. For example, executive bonuses and sales to subsidiaries were very large. *See Bethlehem*, 315 U.S. at 294 (stating that Bethlehem's costs included the sale of 43,000 tons of steel to its shipbuilding subsidiary); BRANDES, *supra* note 26, at 174 (stating that Bethlehem's president gave himself what may be the largest wartime pay increase in U.S. history). Also, it should be noted that the large difference between the estimate and actual cost was partly attributable to the return of peace earlier than expected. Transcript of Record at 1370, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Powell). Attribution of cost reductions to the return of peace undermined the notion that the bonus was

Despite the lack of direct evidence about cost-cutting, the courts ultimately concurred with the Board as to the unfairness of the contract. Although the Special Master expressed ambivalence, the District Judge, all three judges of the Court of Appeals, and all six sitting Justices of the Supreme Court agreed, more or less, that Bethlehem seriously inflated the estimate.²⁵⁰ In reaching this conclusion, it appears they followed the conventional wisdom of the period that high profits were the best available measure of the abuse of market power. Such thinking serves as a reminder of one potential danger of re-pricing after performance, i.e., that the decision-maker will judge the profit-to-cost ratio against a fixed standard without considering the need to reward improved efficiency by the contractor. The government, for its part, conceded in both its appeals that the contract would not have been unconscionable if Bethlehem had adequately explained the discrepancy between the estimate and the actual cost in terms of its own efforts at cost reduction.²⁵¹

Regardless, the courts' resolution of the factual question allowed the judges to reach the critical legal question of what common law recourse the government possessed in the frequent wartime situation where its numerous disadvantages forced it to pay rents to a contractor. That legal question—whether a wartime government was bound to pay a promised increase in price when it got nothing in return—proved decisive for the *Bethlehem* case and for the common law governance of war contracts more generally.

III. DEFENSE CONTRACTS AT COMMON LAW: THE SEARCH FOR A THEORY OF RELIEF

A. WHY THE LITIGATION TOOK SO LONG

Before we analyze the government's arguments, we must briefly consider why so much time passed between the Shipping Board's decision to contest the validity of the contracts in 1923 and the Supreme Court's grant of certiorari in 1940. First, the specifics of the narrative. The Justice Department in 1924 hired a private law firm in Philadelphia to handle the case.²⁵² The following year, that firm filed a bill in equity in

attributable to Bethlehem's cost-saving efforts, though it bolstered the notion that the estimate was a good-faith estimate of *wartime* costs *ex ante*.

250. See *infra* text accompanying notes 331–37, 351–54, 369–71, 624, 627–30; *Bethlehem*, 315 U.S. at 319–23 (Frankfurter, J., dissenting).

251. Govt. Sup. Ct. Br., *supra* note 220, at 75, 84–85; Brief in Behalf of the U.S. and the U.S. Shipping Bd. Merch. Fleet Corp. at 31–32, *United States v. Bethlehem Steel Corp.*, 113 F.2d 301 (3d Cir. 1940) (Nos. 7045 & 7046) (National Archives—Mid-Atlantic Region, Philadelphia, PA).

252. Letter from [James M. Beck], Acting Attorney General, to Henry P. Brown, Spec. Assistant to Attorney General (Mar. 29, 1924) (Section 1, DOJ-NA, *supra* note 123) (stating that Henry P. Brown has been appointed). Henry P. Brown's son and partner, Joseph J. Brown, was appointed a representative of the government in 1926. Letter from William D. Mitchell, Attorney General, to Rep. William B. Oliver (Dec. 4, 1929) (Section 4, DOJ-NA, *supra* note 123). In 1928, when Henry P. Brown

federal court in the Eastern District of Pennsylvania.²⁵³ It took until 1931 to finish the hearings before the Special Master.²⁵⁴ The next year, the Master ruled against the government but then withdrew his report, only to issue effectively the same ruling in 1935.²⁵⁵ The U.S. Maritime Commission (the successor agency to the Shipping Board) wrested control of the case from the private firm in 1937.²⁵⁶ The case was then decided in the District Court in 1938 and the Third Circuit in 1940.

Looking back on the case, Jackson said he "never found any adequate explanation" for this "great delay."²⁵⁷ Indeed, the sources do not reveal a definitive reason. Still, several factors surely had an effect. Bethlehem was slow to produce documents.²⁵⁸ The original Special Master, Owen J. Roberts, was appointed to the Supreme Court midway through the proceedings and had to be replaced by William Clarke Mason, a private attorney.²⁵⁹ The original District Judge also had to be replaced.²⁶⁰ Most important, the government's main attorneys up to 1937 were preoccupied with full-time private practices of their own, as was the Master himself.²⁶¹ The Justice Department, for its part, failed to hold these outside lawyers accountable.²⁶² Up to 1937, not a single full-time

died, Joseph J. Brown had already assumed primary responsibility for the case. Letter from George R. Farnum, Assistant Attorney General, to [John T. Sargent], Attorney General (Nov. 20, 1928) (Section 4, DOJ-NA, *supra* note 123).

253. Bill of Complaint at 1934, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

254. Letter from Joseph J. Brown, Spec. Assistant to Attorney General, to J. Frank Staley, Assistant Attorney General (Apr. 6, 1931) (Section 4, DOJ-NA, *supra* note 123) (stating that the hearing just ended).

255. Master's Report, *supra* note 174, at 518-19, 566 (giving dates); Memorandum from J. Frank Staley, Assistant Attorney General, to the Assistant Attorney General Morris (Jan. 10, 1936) (Section 5, DOJ-NA, *supra* note 123) (stating that the second report gave "approximately the same results" as the initial one); Letter from Roy St. Lewis, Assistant Attorney General, to Joseph J. Brown, Spec. Assistant to Attorney General (Feb. 24, 1932) (Section 4, DOJ-NA, *supra* note 123) (confirming that the initial report was a defeat for the government).

256. See *infra* text accompanying notes 339-42.

257. Robert H. Jackson, Oral History 997 (1954) (Box 191, RHJ-LC, *supra* note 22).

258. *Nye Hearings*, *supra* note 143, at 5780-81.

259. Master's Report, *supra* note 174, at 517-18.

260. Letter from J. Frank Staley, Assistant Acting Head, Adm. Div., to Joseph J. Brown, Spec. Assistant to Attorney General (Feb. 16, 1931) (Section 4, DOJ-NA, *supra* note 123) (stating that, after the original District Judge was appointed to the Third Circuit, the Attorney General unsuccessfully asked the Chief Judge of the Third Circuit to let him hear the case anyway); Memorandum from J. Frank Staley, *supra* note 255.

261. Letter from Roy St. Lewis, Assistant Attorney General, to Homer Cummings, Attorney General (May 2, 1933) (Section 4, DOJ-NA, *supra* note 123) (stating, after nine months of waiting for the Master's report, that the Master was "an outstanding lawyer and a very busy one"); Letter from George R. Farnum, Assistant Attorney General, to John T. Sargent, Attorney General (Feb. 24, 1927) (Section 3, DOJ-NA, *supra* note 123) (stating that the firm representing the government did not dedicate itself full-time to the case, but was "pretty busy in other matters," still attending to its private clients).

262. At least one Justice official tried to get the Browns fired for their "conspicuous lack of initiative." Memorandum from George R. Farnum, Assistant Attorney General, to Attorney General

lawyer at the Department knew much about the case.²⁶³ During the Master's inexplicable delay in issuing his final report from 1932 to 1935, top officials had not a clue what was happening.²⁶⁴ In the wake of World War I, the Attorney General had warned that the explosion in governmental civil litigation could not be efficiently handled if the Justice Department continued its traditional reliance on part-timers.²⁶⁵ *Bethlehem* exemplified the pathologies of that outdated system.

B. POSSIBLE COMMON LAW APPROACHES TO DEFENSE CONTRACTS

From when they started the dispute in 1923, government attorneys faced an uphill climb. The bare substantive imbalance between what was given and received did not itself warrant a judicial refusal to enforce a contract as written. For a court to override the results of a bargain, there had to be some more specific authorizing doctrine, such as fiduciary duty, public policy, duress, mistake, misrepresentation, or incapacity. A contract might be modified on the ground of unconscionability, a doctrine directly triggered by uneven exchange. But this required some evidence that one of the authorizing doctrines listed above was in play. In cases of the most extreme imbalance, the contract might be declared unconscionable without any such free-standing evidence, but this occurred only because the severity of the imbalance itself confirmed that something must have been amiss in the bargaining process.²⁶⁶

(Feb. 24, 1927) (Section 3, DOJ-NA, *supra* note 123). Yet the Browns stayed on. A year later, and three years before the hearings ended, the Attorney General was still worrying about the lack of attention showed in the case by the Browns. Letter from John G. Sargent, Attorney General, to Chauncey G. Parker, General Couns. to the Shipping Bd. (Apr. 11, 1928) (DOJ-NA, *supra* note 123).

263. Letter from J. Frank Staley, Assistant Attorney General to Sam E. Whitaker, Assistant Attorney General (Apr. 12, 1937) (Section 5, DOJ-NA, *supra* note 123) (stating that Justice Department lawyers know too little about the case to "make any intelligent observation about the argument"); Memorandum from J. Frank Staley, Assistant Attorney General, to the Assistant Attorney General Morris (Jan. 10, 1936) (Section 5, DOJ-NA, *supra* note 123) (stating that nobody in the Justice Department has had "active connection with the litigation").

264. Memorandum from William D. Mitchell, Attorney General, to Mr. Gardner (Dec. 13, 1932) (Section 4, DOJ-NA, *supra* note 123) (stating that the report was to appear "in the near future"); Letter from [Homer Cummings], Attorney General, to Rep. James V. McClintic (Mar. 5, 1934) (Section 4, DOJ-NA, *supra* note 123) (stating that the report is expected "any day"); Letter from George C. Sweeney, Assistant Attorney General, to South Trimble Jr., Solic. of the Dep't of Com. (July 6, 1934) (Section 4, DOJ-NA, *supra* note 123) (stating that the Master would consider the report later that summer).

265. 1924 ATTORNEY GENERAL ANN. REP. I.

266. Paul A. Sweeney, Spec. Assistant to the Attorney General, Am. Electro Prod. Co.: Brief on the Law of Unconscionable Contracts at 26 (ca. 1923) (Entry 300, Records of the War Transactions Section, Records of Other Department of Justice Organizations 1918-27, 1930-43, 1964-88, Record Group 60, National Archives, College Park, MD). For later commentaries on procedural and substantive elements of unconscionability, see John P. Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 281 (1947); Arthur Allen Leff, *Unconscionability in the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 486-88 (1967); EDWARD J. MURPHY ET AL., *STUDIES IN CONTRACT LAW* 516-17 (5th ed. 1997).

Government attorneys in the *Bethlehem* case were to spend years searching for the doctrine that would authorize a court, when faced with a factually evident unfairness, to remedy it.

I. *The Fiduciary Duties of Government Officers and Defense Contractors*

In 1922–1923, before litigation began in earnest as to the validity of the Bethlehem contract, several attorneys at the Shipping Board, as well as an attorney at the Justice Department who advised them, brainstormed theories of relief for imbalanced wartime contracts.²⁶⁷ The most important of these theories centered on trust law. Its relevance stems from the broader relationship between trust law and government contracting. In private law generally, a trustee was bound by a duty of absolute loyalty to the beneficiary and a duty of ordinary care in managing the trust property.²⁶⁸ If a trustee transferred property to a third party in a way that breached the trust, the beneficiary had a right to recover the property or its fruits, unless the third party had given legally sufficient consideration for the property and possessed neither actual nor constructive knowledge of the breach.²⁶⁹ According to the Supreme Court, government officers were trustees of the public fisc. What is more, every contractor was constructively “held to a recognition of the fact that government agents are bound to fairness and good faith as between themselves and their principal.”²⁷⁰ Hence, if the contractor should have known that a government agent was acting in a way that breached the duty of loyalty or care, the government was not bound by the deal.

This principle, in the sphere of the duty of loyalty, made for easy cases. Proof that the negotiating officer accepted a bribe from the contractor revealed a breach of trust and invalidated the contract.²⁷¹ Applying the principle in the sphere of the duty of care was trickier. How carelessly did an officer need to behave for a contractor to be charged with awareness of his breach? In one leading case, the Supreme Court attested that when the government “comes down from its position of

267. Geoffrey Goldsmith, Assistant Couns. to the U.S. Shipping Bd., *Emergency Fleet Corp., The Law as to Unconscionable Price in Government Contracts* (June 14, 1922) (Special Reports, File C, Drawer 1, Records Relating to the Bethlehem Steel Corporation, Records of the Department of Claims, Records of the U.S. Shipping Board, Record Group 32, National Archives, College Park, MD); Ralph E. Moody, Spec. Assistant to the Attorney General, *Compilation of Authorities on and Discussion of War Contracts and the Relation of the Citizen to the Government* (1922), *reprinted as appendix to Memorandum on Behalf of Bethlehem*, *supra* note 123; Parker, *supra* note 233. Moody's memo influenced the Shipping Board. See *Memorandum on Behalf of Bethlehem*, *supra* note 123, at 5.

268. GEORGE GLEASON BOGERT, *HANDBOOK OF THE LAW OF TRUSTS* 329–30 (1921).

269. *Id.* at 508–20; 2 JAIRUS WARE PERRY, *A TREATISE ON THE LAW OF TRUSTS AND TRUSTEES* 1312 n.(a) (Edwin A. Howes, Jr. ed., 6th ed. 1911).

270. *Hume v. United States*, 132 U.S. 406, 414 (1889).

271. *United States v. Carter*, 217 U.S. 286, 305–06 (1910); *Garman v. United States*, 34 Ct. Cl. 237, 242 (1899); see also SHEALEY 2d ed., *supra* note 144, at 12–13.

sovereignty, and enters the domain of commerce, it submits itself to the same laws that govern individuals there.” If the state failed to hire competent agents, then it had to “be charged with the consequences that follow such omissions in the commercial world,”²⁷² suggesting that careless transactions would still be enforced. Despite this sweeping rhetoric, the federal courts did in some cases relieve the government of contractual losses caused by the negligence of its employees. However, aside from cases in which the negligent officer had no authority to award the contract at all,²⁷³ courts limited such relief to the most obviously unfair bargains. The Court of Claims, in a much-cited case arising from the Civil War, refused to enforce a government contract whose price was five times market value.²⁷⁴ The opinion announced that, “whenever there are circumstances to excite suspicion,” such as the five hundred percent overcharge, a court would “look narrowly into the case and hold the party who seeks to enforce such a contract to stricter proof of fairness than would be required between two [private] individuals.”²⁷⁵ The massive overcharge, said the court, meant that the contractor had either bribed the government agent or taken advantage of his ignorance. Even if it was the latter, the contract still entailed a breach of trust and was therefore invalid.²⁷⁶

The Supreme Court followed similar reasoning two decades later in *Hume v. United States*, in which a clerk’s error led to a price thirty-five times greater than market value. To collect on such a contract was to force government officers to breach their duty to the public fisc, which the Court would not permit.²⁷⁷ *Hume* also declared that a contract so unconscionably imbalanced created a presumption of fraud (i.e., unconscientious dealing) even without direct evidence thereof.²⁷⁸

These cases made clear that the duty of care for public trustees had very limited application to pricing. It seemed to touch only those contracts (in the words of *Hume*) that “no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other.”²⁷⁹ Given this high threshold, it is no surprise that, from when *Hume* was decided in 1889 through the mid-

272. *Cooke v. United States*, 91 U.S. 389, 398 (1875). For a modern analysis of the general issue of whether the government is bound by ordinary private law when it makes contracts, see Joshua I. Schwartz, *Liability for Sovereign Acts: Congruence and Exceptionalism in Government Contracts Law*, 64 G.W. L. REV. 633, 637–38 (1996).

273. SHEALEY 2d ed., *supra* note 144, at 16–18.

274. *Beard v. United States*, 3 Ct. Cl. 122, 130 (1867).

275. *Id.* at 129.

276. *Id.* at 128.

277. *Hume v. United States*, 132 U.S. 406, 414–15 (1889).

278. *Id.* at 414; *see also* SHEALEY 1st ed., *supra* note 144, at 4–5. On fraud’s general meaning of “unconscientious dealing,” *see* BLACK’S LAW DICTIONARY 685 (8th ed. 2004).

279. *Hume*, 132 U.S. at 415.

1920s, not a single reported federal decision applied the case's holding that an unfair price, in the absence of corruption, could serve as the basis for a breach of trust.²⁸⁰

Attorneys who worked for and advised the Shipping Board wanted to take advantage of the trust theory articulated in *Hume*.²⁸¹ To do so, however, they would have to convince a court that the contracts at issue were "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other."²⁸² Bethlehem's riskless profit of twenty-two percent might be senseless and unfair in a common-sense way, but from a legal perspective, it did not compare with the exponential imbalances in *Hume* and *Beard*. Besides, *Hume* and *Beard* both involved government officers who were, if not corrupt, at least negligent. In the *Bethlehem* case, by contrast, Radford and Bowles had simply done what any reasonable person would do in a desperate situation. As the Court of Claims said in a leading case, the "diligence and care required of a purchasing agent," when in grave need of goods and under time pressure, was "no higher than that which a prudent, energetic man would exercise, in like circumstances, in his own business affairs."²⁸³ By this standard, the court found that a price forty percent greater than usual, agreed to because there were no low-cost suppliers in the area, was valid as within the government agent's authority.²⁸⁴

Faced with these adverse precedents, government attorneys sought to turn trust law to their advantage by positing a different theory: not only the contracting officer, but also the contractor itself, was a trustee of the government.²⁸⁵ This innovation, if accepted, made a huge difference. Under the old, familiar principle, a government contract was treated as one between a trustee (the officer) and a third party (the contractor). This meant the trustee, if not personally interested in the deal, had to exercise the care of an ordinary person, nothing more.²⁸⁶ And even this

280. This is based on a LEXIS search for all federal cases citing *Hume* (i.e., all those containing the citation "132 U.S. 406") from 1889 through 1926. For a narrow construction of *Hume* in response to the government's citation of the case in relation to the interpretation of a statute on the pricing of war contracts, see *Standard Steel Car Co. v. United States*, 60 Ct. Cl. 726, 737-41 (1925).

281. *Hume* and its trust theory are invoked in *Goldsmith*, *supra* note 267, at 33-37; *Moody*, *supra* note 267, at 14-15; *Parker*, *supra* note 233, at 4-5.

282. *Hume*, 132 U.S. at 415. *Moody* argued that "no honest and fair man would accept" a government contract providing for greater than just compensation and that this was enough for invalidation. *Moody*, *supra* note 267, at 22. This reading was contrary to *Hume*'s clear emphasis on the wild unbalance in the contract.

283. *Wentworth v. United States*, 5 Ct. Cl. 302, 311 (1869). Technically, the court was construing a statute, but it derived its conclusion from the common law, not the statutory text. *Id.* at 310-11.

284. *Id.* at 308 (stating the overcharge), 311-12 (giving the holding).

285. *Goldsmith*, *supra* note 267, at 26-29; *Moody*, *supra* note 267, at 15; *Parker*, *supra* note 233, at 4.

286. *BOGERT*, *supra* note 268, at 329.

modest standard, as we have seen, was weakly enforced.²⁸⁷ Under the radical new theory, however, a government contract was treated as one between a trustee (the contractor) and a beneficiary (the government). In such an agreement, the trustee had to act “wholly for the benefit of the beneficiary.”²⁸⁸ Courts viewed such a contract “with great suspicion and jealousy.”²⁸⁹ The trustee had to treat the beneficiary “with the utmost fairness and openness and pay an adequate consideration for all that he receives.”²⁹⁰ *Adequate* consideration, as distinct from the mere *sufficient* consideration necessary to enforce a typical contract, meant equal value.²⁹¹ It was a mandate for judicial price regulation, one long exercised with vigor in the private law of trusts.

How could the government convince a court to adopt this theory? Some attorneys argued that the contractor’s trustee status was inherent in citizenship, since a democratic commonwealth was an association for the mutual benefit of its members, in which all owed allegiance.²⁹² Others said the status came into being, or became stronger, when citizens supplied the state with the means to conduct war.²⁹³ As a matter of policy and justice, this last argument was not crazy. The nation needed contractors’ services as badly as it needed young men to take up arms. If the latter were expected to fight and risk their lives in the trenches at low wages, couldn’t the former be expected, at the very least, to conform to a higher standard than absolute self-interest, especially since the market in total war was not as efficient as in peace? Seeing as how the nation had never depended on big companies for national security as much as it did in World War I, it was not outlandish to ask courts to rethink the state-contractor relationship.

Unfortunately for the government, “no *overt* case-language” supported the theory.²⁹⁴ For this reason, it did not stand up in court. The government invoked the theory for the first and last time in 1923, in a fraud suit against the Bentley Company arising from an enormous wartime construction project notorious for waste and corruption.²⁹⁵ The District Judge, while noting that fairness would “be more rigidly scrutinized than if [the contractor] had been dealing with a private

287. See *supra* text accompanying notes 272–84.

288. BOGERT, *supra* note 268, at 332.

289. *Id.* at 334–35; see also *Kelton v. United States*, 32 Ct. Cl. 314, 348 (1897) (stating that a contract between a public trustee and the government would “always” be “set . . . aside for the asking”).

290. BOGERT, *supra* note 268, at 334–35.

291. BLACK’S LAW DICTIONARY 324–26 (8th ed. 2004).

292. Moody, *supra* note 267, at 2–15.

293. Goldsmith, *supra* note 267, at 29; Parker, *supra* note 233, at 4.

294. Goldsmith, *supra* note 267, at 26.

295. BRANDES, *supra* note 26, at 151–55, 188; *United States v. A. Bentley & Sons Co.*, 293 F. 229 (S.D. Ohio 1923).

individual,²⁹⁶ found “no cases” to support the trustee status of the contractor.²⁹⁷ He threw out the argument. The government did not appeal.²⁹⁸ This defeat appears to have soured the government on using the theory in subsequent cases.

The theory of the defense contractor as trustee exemplified a radical approach to curtailing war profits. It would have transferred defense contracting to the strictest sector of fiduciary relations—a region insulated from the market, where judicially crafted standards of fairness came first and the actual terms of a contract came second. The theory’s startling implications may well explain its rejection.

2. *An Incremental Approach: Separate Consideration in Savings Contracts*

At the same time, government attorneys recognized, and judges fleshed out, a more incremental approach to the challenge. If a court could not openly look behind every defense contract to decide whether its substance was fair, it could at least identify certain elements of contract format that tended to produce excessive profits and then manipulate the doctrines of contract law to blunt their effect.

The treatment of savings contracts (the same format used in the *Bethlehem* case) by the Court of Claims after the First World War serves as a good example of this incremental approach. The story began with a series of cases concerning contractors who made clothing for the Army. The government provided fabric to these manufacturers and soon concluded, in the midst of performance, that they were wasting too much of it. Government officers therefore modified the agreements: each contractor was to use “best efforts to avoid all possible waste” and would receive, as added compensation, one-fifth the value of fabric saved.²⁹⁹ This modification gave rise to several disputes resolved by the Court of Claims in 1923–1926, all in unanimous five-judge decisions. Concluding that the contractors were obligated to avoid waste even under the original agreements, the court, following a strict reading of the preexisting duty rule, said the savings clause could not be enforced without fresh consideration. What is more, the court interpreted the savings provision (with almost no evidence, in the text or otherwise) to require such consideration in the form of cost-saving efforts on the part of the contractor that it had not made, or would not have made, under

296. *A. Bentley*, 293 F. at 236.

297. *Id.* at 235–36.

298. In a later order, apparently not reported, the District Judge dismissed the complaint altogether and was affirmed, on grounds separate from the trust issue, in *United States v. A. Bentley & Sons Co.*, 16 F.2d 895 (6th Cir. 1927).

299. *F. Jacobson & Sons v. United States*, 61 Ct. Cl. 420, 423–24 (1926); *Cohen, Endel & Co. v. United States*, 60 Ct. Cl. 513, 513–15 (1925); *J.J. Preis & Co. v. United States*, 58 Ct. Cl. 81, 81–82 (1923).

the original agreement.³⁰⁰ If the contracts were allowed to stand without such a requirement, noted the court in dicta, they might be invalid not only for want of consideration, but also as contrary to the public policy against gifts of public money.³⁰¹ If the contractor fulfilled the judicially-imposed requirement of extra cost-saving efforts, it received the bonus; otherwise, it did not.³⁰²

Denial of unearned profit was the stated goal and the end result of the court's approach. Yet there was a big difference between its incrementalism and the radical theory of contractor-as-trustee. Under the trustee theory, the court based its intervention on the total profit of the contractor and the total benefit to the government. The fabric cases, by contrast, focused narrowly on modifications to the contract and their format. The court never mentioned the contractors' overall profit. Indeed, the bonuses appear to have been small, about one percent of the cost of material, or less.³⁰³ These cases did not represent some judicial campaign to identify and police the most exploitative defense contracts.

It should be no surprise that the profits denied in these cases were not particularly large. The court singled them out for non-enforcement simply because they ran afoul of the preexisting duty rule—a rule whose application might bear *some* correlation to excessive profits (e.g., via mid-stream hold-ups) but not necessarily a strong one.³⁰⁴ To a critic of war profits, then, the rule was weak as an instrument of policy. Still, it had the virtue of allowing a cautious judge to intervene in a problem that might otherwise have gone untouched. It permitted the judge, in overriding the contract, to rely on the categorical and ostensibly neutral distinctions with which courts were most comfortable, in contrast to the unusual field of trustee-beneficiary transactions, which entailed messier questions of fairness.

Things got more tricky when the Court of Claims confronted a wartime savings contract executed all in one piece. In *Burke & James v.*

300. *F. Jacobson*, 61 Ct. Cl. at 424–25; *Cohen*, 60 Ct. Cl. at 518–19; *J.J. Preis*, 58 Ct. Cl. at 86. At no point in any of the decisions does the court say that the actual intent of the parties was that the contractor be denied the bonus without extra effort. Indeed, the contracts contained no specification of any extra effort or how it was to be measured.

301. *J.J. Preis*, 58 Ct. Cl. at 86. Note there was Supreme Court authority (not cited in *J.J. Preis*) stating that judges had greater reason to be on the look-out for failure of consideration in government contracts cases than in private ones, due to the negligence and bad faith of government agents. *United States v. Barlow*, 132 U.S. 271, 282 (1889).

302. *F. Jacobson*, 61 Ct. Cl. at 424; *Cohen*, *Endel*, 60 Ct. Cl. at 519; *J.J. Preis*, 58 Ct. Cl. at 87.

303. *Burke & James, Inc. v. United States*, 63 Ct. Cl. 36, 56 (1927) (noting the “comparatively small percentage between the yardage actually used and the allowance” in the fabric cases); *J.J. Preis*, 58 Ct. Cl. at 84 (noting that, in the disputed transaction, the contractor returned to the government 3.5% of the cloth provided to it, of whose value it would have received 20%).

304. Indeed, as a practical matter, it is notoriously hard to predict whether a court will apply the preexisting duty rule in a case where formally it should. 1 STEWART MACAULAY ET AL., *CONTRACTS: LAW IN ACTION* 309 (1995).

United States, decided in 1927, the contractor's estimate turned out to be far above actual cost, producing a profit of sixty-four percent.³⁰⁵ There was no allegation of bad faith.³⁰⁶ Rather, the contractor simply made an "egregious error" in the estimate.³⁰⁷ Whereas the savings bonuses in the fabric cases had been relatively small, the one in *Burke & James* resulted in a large and undeniable rent. Yet this time, though the imbalance cried out for remedy, the court was stripped of the rationale of the preexisting duty rule.

What to do? The judges split, three to two. The majority concluded that a savings contract, even when executed all in one piece, should be construed to require separate consideration for the savings bonus.³⁰⁸ But what was the separate consideration to be? In contrast to the fabric cases, there was no original contract to serve as a baseline. The court answered that the contractor, in order to get the bonus promised in the text of the agreement, had to do "more than the precise terms of the contract exacted of it," e.g., to expend "additional sums . . . to effect a saving in materials," exert "extraordinary care in the use of materials," or employ "additional labor."³⁰⁹ There was no evidence that the contractor did any of this, so the court denied the bonus.³¹⁰

This interpretation flew in the face of the contract's wording.³¹¹ With no hard evidence in either party's actions, the court could only say that, in light of the "purpose" of the savings provision, the consideration for the bonus had to be "a reduction in the cost of materials below the contract allowance."³¹² This twisted the meaning of consideration. Surely the government's consideration for the savings provision—i.e., the thing that induced the government to include the provision in the contract—was not cost reduction *per se*, but the *incentive* that the bonus gave the contractor to reduce costs. The court's assertion that consideration meant an *actual* monetary benefit was no less absurd than saying that consideration fails whenever a party enters a contract for the purpose of making a profit but does not actually make one. As one government attorney privately admitted, the construction was "unjustified and wholly at odds with the intentions of the parties."³¹³

305. *Burke & James*, 63 Ct. Cl. at 52.

306. *Id.* at 58.

307. *Id.* at 53.

308. *Id.* at 52-58.

309. *Id.* at 55.

310. *Id.* at 58.

311. *Id.* at 53 (admitting that "the letter of the agreement" results in unconscionable profits).

312. *Id.* The invocation of a failed contractual purpose was a common way for courts in this period to fudge doctrine to reach an equitable result. Karl N. Llewellyn, Book Review, 52 HARV. L. REV. 700, 702 (1939).

313. Memorandum from Paul Page, Attorney, Maritime Comm'n, to Robert H. Jackson, Solicitor General 5 (1939) (Folder labeled "Legal File—Attorney General—Bethlehem Steel Case," Box 86,

After its extensive discussion of the interpretation and consideration issues, the court briefly added an alternative rationale for judgment against the contractor: unconscionability. Under this heading, the court emphasized that the government reasonably relied on the contractor's expertise when the latter made the estimate; that the contractor made a "gross error" in the estimate; and that the savings bonus, based on the estimate, raised the contractor's profit to sixty-four percent from twenty-six percent. (The latter figure was the fixed fee, which the government did not seek to recover, even though it, too, was inflated by the error.) The combination of these factors, declared the court, rendered enforcement of the bonus unconscionable.³¹⁴

Of the court's two rationales, unconscionability may seem far more plausible since it aimed at the goal of fair exchange openly and directly, not by way of tortured interpretations or the manipulation of consideration doctrine. Why, then, didn't the court rely on unconscionability alone? While the particular format of the savings contract limited the applicability of the requirement of separate consideration, unconscionability's focus on the contractor's total profit could conceivably be applied to any contract with a profit around sixty-four percent or higher (provided there was also some procedural problem, such as the contractor's estimation error). With the decision commanding only a slim majority, perhaps the judge casting the swing vote felt uncomfortable stating that unconscionability by itself could invalidate a sixty-four percent profit. After all, this profit was far lower than the exponential returns that went unenforced in *Hume* and *Beard*. It brought the court within striking distance of ordinary war profits. By coupling unconscionability with separate consideration, the court left itself an "out" in case the government later asked it to invalidate contracts devoid of a savings clause but with large profits.

What is more, the court's reliance on interpretation and consideration allowed for a clear and seemingly neutral determination of how much the contractor could recover: the court simply denied the savings bonus. Without this determination in the background, unconscionability would have required the court to exercise discretion far more openly in choosing a number, since the products involved (newly invented aerial cameras) had no determinate market value separate from the exigencies of the war itself—a common situation in war contracting. Hence, even though the court invoked unconscionability, separate consideration remained integral to its approach. It seems doubtful that it would have invoked the former

RHJ-LC, *supra* note 22).

314. *Burke & James*, 63 Ct Cl. at 58–60. For the numbers, see *id.* at 51–52. The 26% figure is the fixed fee of \$34,600 divided by the total cost of \$130,659.50.

without the latter.

As a way to address war profits, the incremental approach of *Burke & James* had some merit. The savings contract might provide a useful incentive but could also be abused. Adding a requirement of special efforts avoided throwing out the baby with the bathwater, even if the court's fact-findings on that matter were rather cursory. At the same time, the approach had severe problems. First of all, it rested on a method of construction that flaunted the evidence. This made it easy for courts in other jurisdictions to refrain from adopting the approach; they had only to point out the absurdity of the logic.³¹⁵ And there was another, more subtle, problem. While the court's rhetoric made clear that it wanted to prevent contractors from obtaining unearned profits, the approach was anchored to the savings format. Thus, the court could not reach excessive profits that arose, say, from a fixed-price contract, or from a fixed fee based on an inflated estimate, or (in a concealed way) from the inflation of cost in a cost-plus arrangement. By contrast, the theory of contractor-as-trustee would have reached all such profits.³¹⁶

C. THE MASTER'S HEARING: NO MISREPRESENTATION, ONLY BARGAINING POWER

Once the *Bethlehem* litigation began, the government faced a choice between the radical theory of contractor-as-trustee and the incremental approach of *Burke & James*.³¹⁷ Joseph J. Brown, the private attorney who represented the government before the Master in 1932, presented an odd variation on the *Burke & James* argument. The *Burke & James* court had concluded, on the basis of the savings format, that the contract's "purpose" was for the savings bonus to accrue only as a result of the contractor's cost-saving efforts. This "purpose," implied the court, was the parties' actual intent and ought to be enforced, despite the letter of the contract. In the *Bethlehem* case, Brown claimed that the government had reasonably relied on a false representation by Bethlehem that the contract was structured in such a way that the savings bonus would accrue only as a result of an increase in Bethlehem's efficiency. Specifically, according to Brown, Bethlehem made the government think that the estimates were accurate predictions of what the cost would be, given the firm's current efficiency and assuming no increases in cost from

315. See *infra* text accompanying note 350.

316. Indeed, the government in *Bentley* apparently sought to use that theory to contest cost allowances in a cost-plus contract. *United States v. A. Bentley & Sons Co.*, 293 F. 229, 245 (S.D. Ohio 1923) (recounting the government's claim that cost allowances requested by the contractor and previously allowed by the government were fraudulent).

317. The same attorneys who posited the radical theories simultaneously recognized and invoked the argument that a savings contract required separate consideration. Moody, *supra* note 267, at 23; Parker, *supra* note 233, at 6.

any source.³¹⁸ The government, attested Brown, actually understood the savings contract in the way that the court in *Burke & James* had imputed to the parties—that there would be no “additional compensation unless it was *earned* as a result of economies effected” by the contractor.³¹⁹ But contrary to Bethlehem’s representations, continued Brown, the estimates *did* allow for increases in cost, leading to the excess of the estimate over actual cost.³²⁰ Therefore, he concluded, the contract was invalid on the ground of misrepresentation. As a remedy, Brown wanted Bethlehem’s profit reduced to zero, on a punitive damages theory.³²¹ Alternately, he wanted it limited to ten percent of actual cost, which, he said, was customary in wartime shipbuilding.³²² The latter option called for a profit about equal to the fixed fee, meaning that it approximated the usual remedy for misrepresentation, i.e., placed the government in the position it would have occupied had the contract been as Bethlehem led it to believe.³²³

The evidence for Brown’s story, as one government attorney privately admitted, was “woefully weak.”³²⁴ Brown had no effective answer to the overwhelming evidence that the EFC did not view the estimates as close predictions of cost. Powell flatly told the EFC that the estimates made allowances for possible future cost increases.³²⁵ Piez, who had experience with savings contracts, testified that the estimate in such a contract had to include “actual cost, if we knew the cost, plus an allowance for contingencies,” not to mention other allowances.³²⁶ Most important, Radford and Bowles explicitly stated that they considered the estimates too high. They assented because the nation needed the ships regardless of price, without mentioning any reliance on Bethlehem’s

318. Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. at 19–21 (on the understanding), 273–318 (on reliance by the government), *United States v. Bethlehem Steel Corp.*, 23 F. Supp. 676 (E.D. Pa. 1938) (Nos. 3315 & 11970) (Enclosures, DOJ-NA, *supra* note 123).

319. *Id.* at 34 (emphasis in original).

320. *Id.* at 51–61, 226–72.

321. *Id.* at 321–22.

322. *Id.* at 337.

323. In his discussion of remedies, Brown made only the punitive-damage argument (allowing no profit) and the “customary profit” argument (allowing profit of ten percent of actual cost). *Id.* at 321–37. He did not refer to expectancy as the measure of damages. *Id.* However, in the next stage of litigation, the government stated that it had been “damaged to the extent that the base costs were inflated.” District Court Brief at 94, *Bethlehem*, 23 F. Supp. 676 (Nos. 3315 & 11970) (National Archives—Mid-Atlantic Region, Philadelphia, Pa.). This measure would suggest expectancy as the proper remedy, even though the government officially stuck to the punitive damages theory. *Id.* at 25–26. Brown’s theory of allowing only a ten percent profit on actual cost was jettisoned. *Id.*

324. Memorandum from Paul Page, *supra* note 313, at 1. Page did note that the government might argue fraud on a different basis: that Bethlehem had warranted its estimates as fair and reasonable, when they surely were not. *Id.* at 2.

325. Record at 1825, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9) (Exhibit G-109, Letter from Joseph W. Powell to the Emergency Fleet Corp.).

326. Transcript of Record at 1500–01, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9) (Testimony of Piez).

representations.³²⁷

Though unsupported by the facts, Brown's theory might have been attractive to an adjudicator who wished to make the contract more fair, but in a hidden way. Effectively, Brown dreamed up a contract that would have been fair, i.e., that would have guaranteed that Bethlehem's bonus came only from its cost-saving efforts, not from the inflation of its estimates. He then posited (falsely) that the EFC had bargained for this idealized contract. Brown's theory gave the court the opportunity to enforce an approximation of this idealized contract, but in a way that set no precedent, since it merely required the court to misconstrue the idiosyncratic facts of a single case.³²⁸

The success of Brown's strategy depended on the willingness of the adjudicator to indulge a sympathy for the party suffering the unfairness. But the Master did not indulge. In his report, submitted in 1935, Mason rejected the claim of misrepresentation, correctly noting there was no reliance: "The Government has not produced a word of testimony to prove that, had the Government representatives known exactly what the profit to Bethlehem under the contracts . . . eventually would be, the contracts in question would not have been made."³²⁹

Bethlehem's profit resulted not from fraud, but from bargaining power, pure and simple. Mason acutely understood the government's dependence on private organizational capacity in wartime: "It was Bethlehem's organization that was necessary to insure success to the shipbuilding program of the Fleet Corporation." Seizure, Mason knew, would have been counter-productive. "[T]he taking possession by the Fleet Corporation of the Bethlehem plants," he explained, "could not have accomplished the [government's] desired result."³³⁰ Therefore, "if Bethlehem demanded its price on the basis of substantial commercial profits . . . , the Government was obliged to take the contracts on such basis or not at all."³³¹ And the government did take them, "with open eyes," and "did so because of a realization of the necessity of attaining an

327. Master's Report, *supra* note 174, at 530-31.

328. Even though Brown's case rested exclusively on misrepresentation, and not on the theories of separate consideration or unconscionability invoked in *Burke & James*, Brown did include an analysis of *Burke & James* in one of his briefs. Argument in Support of Requests for Findings of Fact and Conclusions of Law Submitted Upon Behalf of the United States of America and the United States Shipping Board Emergency Fleet Corp. at 46, *Bethlehem*, 23 F. Supp. 676 (Nos. 3315 & 11970) (Enclosures, DOJ-NA, *supra* note 123) [hereinafter Second Post-Hearing Brief]. He asserted that, whereas the contractor in *Burke & James* made an error in its estimate, Bethlehem had deliberately falsified its estimate, thus making the case for relief against Bethlehem stronger than against the contractor in *Burke & James*. *Id.*

329. Master's Report, *supra* note 174, at 538.

330. *Id.* at 539. Mason also noted that the government in World War I had no legal power to draft management: it could not "compel performance by an unwilling organization." *Id.*

331. *Id.*

objective . . . which, without Bethlehem, might not be possible.”³³²

According to Mason, the law put no limit on the use of economic pressure, so long as the actors were informed and competent. “[H]ow much one takes from those needing service in necessity,” he pronounced with cold resignation, was merely a “matter of conscience.” It was essential, he concluded, “to pay for such service at the contract price, even though, when the necessity be over, the obligor may regard the weight of his debt unduly burdensome.”³³³

It was a harsh statement, considering that Brown (while not actually relying on a theory of unconscionability) had called Bethlehem’s profit excessive.³³⁴ In response, Mason observed that firms in the highly concentrated shipbuilding industry had made profits comparable to those in the *Bethlehem* case even in the years after the war.³³⁵ (This comparison may have been unfair, since the war contracts entailed no risk, whereas the peacetime ones possibly did.³³⁶) In addition, added Mason, high wartime profits might be justified as a subsidy for Bethlehem, paying it off for maintaining its plants in peacetime and rendering “standby” service, ready to produce when war came.³³⁷ In fact, however, it seems that the motivation for Bethlehem’s massive pre-1917 investment stemmed from the expectation of profit for supplying Britain and other foreign belligerents, not the United States (though there was little fact-finding on this issue).³³⁸

D. THE DISTRICT COURT: “DAYLIGHT ROBBERY, BUT NOT THEFT”

By this point, attorneys at the U.S. Maritime Commission (the

332. *Id.*

333. *Id.* at 540–41.

334. *E.g.*, Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. at 335, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9). There was also a reference to unconscionable profits in Bill of Complaint at 1959, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

335. Master’s Report, *supra* note 174, at 549–51.

336. Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Third Circuit at 16 n.8, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

337. Master’s Report, *supra* note 174, at 540. It should be noted that Mason made one additional ruling in his report. In its original complaint in 1925, the government noted that Schwab as Director General of the EFC limited the profits of other shipbuilders without touching those of his own firm. Bill of Complaint at 1961–65, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9). The General Counsel of the Shipping Board believed that these facts would serve as the basis for a claim of breach of fiduciary duty against Schwab. Letter from Chauncey G. Parker, General Counsel, Shipping Bd., to the Attorney General (Mar. 1, 1926) (Section 3, DOJ-NA, *supra* note 123). However, Joseph J. Brown did not press the claim in his brief in 1932. See Brief Submitted on Behalf of Bethlehem Shipbuilding Corporation, Ltd., et al. & Second Post-Hearing Brief, *supra* note 328; see also Brief . . . On Behalf of Bethlehem Shipbuilding Corp., Ltd. et al. [Bethlehem Post-Hearing Brief] at 66–68 (refuting the claim while noting it is not raised). Mason ruled that Schwab had done nothing wrong, since he simply acted pursuant to an agreement not to deal in any way with Bethlehem in his capacity as Director General. Master’s Report, *supra* note 174, at 542–43. The claim never arose after this.

338. Govt. S. Ct. Br., *supra* note 220, at 56 (citing testimony).

successor agency to the Shipping Board) were fed up with Brown. His strategy, insisted the Commission's General Counsel, Max O'Rell Truitt, was "calculated to lose" the upcoming proceeding in the District Court.³³⁹ When commission attorneys began preparing their own alternate argument,³⁴⁰ Brown resigned.³⁴¹ It was good riddance, declared Truitt, for Brown "had made a good many unfounded charges," which were "responsible for the unfavorable report of the Master."³⁴²

In the District Court, the Commission retained the claim of misrepresentation. In the words of one attorney, "it had been made our story and we were stuck with it."³⁴³ Any hope of victory rested on alternative claims that Commission attorneys added. In particular, they explicitly invoked the theory of *Burke & James* that a savings bonus required separate consideration.³⁴⁴ More important, they claimed unconscionability. The true issue in the case had always been unfair exchange, and unconscionability allowed the court to take account of it directly, not merely in relation to the contract's format or the parties' states of mind. Indeed, the Commission opened its brief by stating that the "ultimate" question in the case was whether Bethlehem should receive profits "*which it has not earned.*"³⁴⁵

Still, unconscionability required some defect in the bargain besides the imbalance itself. Unlike *Hume, Beard*, and *Burke & James*, *Bethlehem* did not involve negligence. The Commission scraped together a few alternatives. One was "the permeating presence of the fraud element."³⁴⁶ This referred to Brown's theory of misrepresentation, as well as Bethlehem's more general representation that the estimates were fair and proper,³⁴⁷ which one Commission attorney thought might be considered deceptive.³⁴⁸ As additional defects, the Commission briefly mentioned the "emergency conditions" under which the contract was made and the general danger that government officers might not serve their trust with zeal.³⁴⁹

339. Letter from unnamed official to J. Frank Staley, Assistant Attorney General (Apr. 1937) (Section 5, DOJ-NA, *supra* note 123) (quoting a conversation with Truitt).

340. Paul D. Page, Jr., Bethlehem Jottings 3 (Sept. 1939) (Section 6, DOJ-NA, *supra* note 123).

341. Letter from Joseph J. Brown, Special Assistant to the Attorney General, to Max O'Rell Truitt, General Counsel, Maritime Comm'n (Sept. 20, 1937) (Section 5, DOJ-NA, *supra* note 123).

342. Quoted in Letter from Sam E. Whitaker, Assistant Attorney General, to Homer Cummings, Attorney General (Sept. 30, 1937) (Section 5, DOJ-NA, *supra* note 123).

343. Memorandum from Paul Page, *supra* note 313, at 2.

344. District Court Brief at 108-18, *United States v. Bethlehem Steel Corp.*, 23 F. Supp. 676 (E.D. Pa. 1938) (Nos. 3315 & 11970) (National Archives—Mid-Atlantic Region, Philadelphia, Pa.).

345. *Id.* at 1-2 (emphasis in original).

346. *Id.* at 107.

347. *Id.* at 55.

348. Memorandum from Paul Page, *supra* note 313, at 2.

349. District Court Brief at 104-05, 107, *Bethlehem*, 23 F. Supp. 676 (Nos. 3315 & 11970) (National Archives—Mid-Atlantic Region, Philadelphia, Pa.). There were no accusations against any

District Judge Oliver B. Dickinson ruled against every one of the government's claims. Handing down his opinion in 1938, he rejected the *Burke & James* theory that the savings bonus required separate consideration, reasonably relying on the contract's wording.³⁵⁰ As for misrepresentation, he followed Mason, ruling that Bethlehem drove a hard bargain which the EFC knowingly accepted. Unlike Mason, however, Dickinson did not leave open the possibility that the bargain was fair. Instead, he denounced Bethlehem for overreaching:

The managers for [Bethlehem] adopted the famous Rob Roy distinction who admitted he was a robber but proudly proclaimed that he was no thief. The contractor boldly and openly fixed the figures in the estimated cost so high as to give them the promise of large bonus profits. The managers for the Fleet Corporation knew that the estimate was high . . . and so protested it. The reply of the contractor's managers was, . . . ["]You take it or leave it." Whatever wrong there was in this may have been the wrong in a daylight robbery but there was no element of deception in it.³⁵¹

Seeing as how Dickinson likened Bethlehem's bargaining to "daylight robbery," one might think he would accept the argument for unconscionability.³⁵² Indeed, he referred to unconscionability as the "real cause of action" in the case.³⁵³ He even cast doubt on the fairness of an incentive contract per se, suspicious that it provided an added incentive for a party to do what it was already obligated to do, creating an "agreement to pay something for nothing."³⁵⁴

Still, even though Dickinson considered it "unholy and sinful to make of the calamity of the people a source of inordinate gain," he insisted that "we are dealing with a matter of contract and not sentiment, patriotic or otherwise."³⁵⁵ He expressed anxiety about the security of contracts. "It may well be thought that of late years," he fretted, in an apparent reference to the New Deal, "we have gone quite far enough toward abolishing the obligation of debt."³⁵⁶ Shocked at Bethlehem's conduct, yet convinced that the contract had to be enforced, Dickinson had backed himself into a corner. He escaped by framing the question in such a way that he had to rule against the government. Just as the court in *Burke & James* cabined its use of unconscionability by simultaneously basing its ruling on the peculiar format of the savings contract, Dickinson treated the issue of unconscionability as a question of whether savings

government officers.

350. *Bethlehem*, 23 F. Supp. at 679.

351. *Id.*

352. *Id.*

353. *Id.*

354. *Id.* at 680.

355. *Id.* at 678-79.

356. *Id.* at 679-80.

contracts were *per se* unconscionable. (Unlike the *Burke & James* court, he did not consider the possibility that their fairness might be judged case by case.) Incentive contracts, of course, were not uncommon in the general run of commerce. In "view of [this] general and common practice," he concluded, "they could not be condemned as unconscionable."³⁵⁷

The government had convinced the court that the contract was morally unfair, but this was not enough to win. Dickinson, grumbled one lawyer at the Commission, was operating under "an unsound theory that 'a daylight robbery' of Government by one of its citizens, while to be condemned upon grounds of patriotic sentiment, may be legally impregnable."³⁵⁸ In the eyes of one Justice official, it was Dickinson, not Bethlehem, who hid behind the Rob Roy distinction: the government now owed Bethlehem several million dollars, "which the court held was daylight robbery, but not theft."³⁵⁹ The judgment, lamented Robert Jackson (then Solicitor General), was one "which the lower court feels compelled technically to grant, although the result shocks the court's conscience. Such a judgment should be resisted to the uttermost."³⁶⁰

E. THE THIRD CIRCUIT: "COMMERCIAL GREED" WITHOUT
"PATRIOTIC FEELING"

Dickinson's rhetoric, though it exasperated government attorneys in light of his ruling, gave them hope for the appeal. Though nearly all the other arguments on the government's side were weak, wrote a Commission attorney to Jackson, unconscionability still stood a chance: "[W]e are forced to concentrate our appeal on the unconscionable results of this contract, to convince the court that to enforce these payments would in effect hold that a robber may successfully defend the proceeds of his robbery in a court of equity"³⁶¹

As the case went to the Third Circuit, the government retained all the arguments it had made below.³⁶² Plus, it repeated the Court of Claims' dictum in the fabric cases that a savings bonus without proof of

357. *Id.* at 680-81.

358. Memorandum from Bon Geaslin, General Counsel to the Maritime Commission, to Frank Murphy, Attorney General 6 (Feb. 14, 1939) (Section 6, DOJ-NA, *supra* note 123).

359. Letter from Sam E. Whitaker, Assistant Attorney General, to Homer Cummings, Attorney General (June 27, 1938) (Section 5, DOJ-NA, *supra* note 123).

360. Memorandum by the Solicitor General Authorizing Appeal from Robert H. Jackson, Solicitor General (Mar. 2, 1939) (Folder labeled "Legal File—Attorney General—Bethlehem Steel Case," Box 86, RHJ-LC, *supra* note 22).

361. Memorandum from Paul Page, *supra* note 313, at 5.

362. The fraud theory was reformulated to say that Bethlehem's superior knowledge imposed on it a disclosure obligation that it violated. Brief in Behalf of the United States of America and the United States Shipping Board Merchant Fleet Corporation at 46-47, *United States v. Bethlehem Steel Corp.*, 113 F.2d 301 (3d Cir. 1940) (Nos. 7045 & 7046) (National Archives—Mid-Atlantic Region, Philadelphia, PA).

cost savings by the contractor violated public policy.³⁶³

Dickinson, as Jackson noted ruefully, was “not a New Deal judge.”³⁶⁴ The panel assigned to the case in the Third Circuit, by contrast, consisted of three Roosevelt appointees.³⁶⁵ Unfortunately for the government, their political background had no effect. Handing down their decision in 1940, the judges adopted the exact same view of the contract as Mason and Dickinson: it was a naked exercise of bargaining power which the law was powerless to redress. Repeating Mason’s point about the government’s dependence on Bethlehem’s administrative resources, the court observed that “Bethlehem’s existing shipbuilding organization” was “necessary to insure success to the program of the Fleet Corporation.”³⁶⁶ Seizure of the plants “could not have accomplished the shipbuilding program with the speed which was essential” to it.³⁶⁷ The EFC was therefore “obliged to accept the terms offered by Bethlehem.”³⁶⁸ The company “cannot be charged with having misrepresented the facts,” though it “may be condemned for having taken advantage of the Nation’s necessities to secure inordinate profits.”³⁶⁹ Indeed, “Bethlehem insisted upon assuring itself a margin of profit which in view of the necessities of the Government was so large as to indicate an attitude of commercial greed but little diluted with patriotic feeling.”³⁷⁰

As for unconscionability, the Third Circuit conceded that “Bethlehem took advantage of the war emergency to drive a hard bargain with the Government.”³⁷¹ This kind of exploitation might be read as a procedural defect that would lessen the requirement for imbalance in the exchange.³⁷² However, the Third Circuit did not consider this possibility, perhaps because the government neglected to raise it. Instead, the court judged the fairness of the transaction by the standard articulated in *Hume* for exchanges so imbalanced that they created a presumption of invalidity without other evidence: the bargain had to be one that “no man in his senses and not under delusion would make.”³⁷³

363. *Id.* at 27–28. The government also added an argument based on breach of fiduciary duty by the contracting officers, based on Court of Claims dicta. *Id.* at 44–46.

364. Letter from Robert H. Jackson, Solicitor General, to Ernest Lindley (Mar. 29, 1939) (Folder labeled “Legal File—Attorney General—Bethlehem Steel Case,” Box 86, RHJ-LC, *supra* note 22).

365. They were Judges Biggs, Maris, and Clark. *Bethlehem*, 113 F.2d at 303. For their appointments, see History of the Federal Judiciary, at <http://www.fjc.gov/public/home.nsf/hisj> (last visited Sept. 23, 2005).

366. *Bethlehem*, 113 F.2d at 305.

367. *Id.*

368. *Id.* at 305–06.

369. *Id.* at 306.

370. *Id.* at 305.

371. *Id.* at 306.

372. See *supra* text accompanying note 266.

373. *Bethlehem*, 113 F.2d at 306 (quoting *Earl of Chesterfield v. Janssen*, (1750) 28 Eng. Rep. 82,

Bethlehem's profit did not rise to this level, since it did not compare with the exponential profits in *Hume* or like cases. Besides, observed the court, fat profits were common in wartime shipbuilding contracts.³⁷⁴ This point reflected one of the biggest limitations of the unconscionability doctrine: in its pure form, it was supposed to police deviations from a fair market price, meaning that if a market exhibited a systemic problem (e.g., excessive prices in war procurement), all contracts were immune to judicial intervention.³⁷⁵

The court dismissed the arguments inspired by *Burke & James* with a passing reference to the text of the agreement.³⁷⁶ As for public policy, the court refused to consider a case-by-case approach, instead deciding only whether savings contracts per se were impermissible, which of course they were not.³⁷⁷ Once again, the government had elicited much outraged rhetoric, but not a single favorable legal conclusion. However unfair the exchange, the courts offered no help.

IV. THE DURESS THEORY AND THE NEW DEAL'S CHALLENGE TO THE DEFENSE INDUSTRY

A. THE JUSTICE DEPARTMENT TURNS THE TABLES

Four days after the Third Circuit handed down its decision, France fell to Hitler. The shockingly swift Nazi victory shattered the assumption, hitherto widespread, that the European conflict would die down to a stalemate. The Second World War, as one American observer recalled, "was going to a decision and it was going with unbelievable speed, and the decision looked as if it would be one we could not live with."³⁷⁸ Confronted with the possibility that Hitler might conquer Europe and attack the United States, Roosevelt urgently requested a new air force of fifty-thousand planes and a two-ocean navy.³⁷⁹ In the latter half of 1940, Congress appropriated thirty-six billion dollars for rearmament.³⁸⁰ By a remarkable accident of history, the *Bethlehem* litigation arrived at the stage of final appeal just as the nation confronted, once again, the question of how to control the cost of war.

Suddenly relevant, the case became the direct responsibility of the Justice Department, at that time under the direction of Robert Jackson. The Department immediately asked the Supreme Court to hear the

100 (Ch.)).

374. *Id.*

375. *Id.* In addition, the court repeated Mason's point that the profits might be considered a subsidy to Bethlehem to insure "standby" service in case of another war. *Id.*

376. *Id.* at 307.

377. *Id.*

378. CATTON, *supra* note 98, at 21.

379. *Id.* at 21-22.

380. Higgs, *supra* note 21, at 171.

appeal. "The Government," announced the petition, "is now engaged in a program of military and naval armament comparable to or greater than that undertaken in 1917 and 1918."³⁸¹ In light of this new reality, "[n]othing less than a decision of this Court should be allowed to settle the doctrine that a court of equity is forced without flinching to apply the harshest rules of a free market . . . to transactions such as these."³⁸²

The courts below had upheld the contract on the ground that it revealed nothing more than the exercise of bargaining power against a nation in need. In a shrewd move, the Justice Department decided to accept this interpretation of the transaction as the brute exploitation of market necessity. But then it turned the tables by arguing that such an interpretation, far from making the transaction legitimate, revealed it to be the product of economic duress.³⁸³ There had to be some boundaries to the permissible use of bargaining power in war. The Court, declared the Justice Department, had to decide "the extent to which the country's need should place the Government at the mercy of its contractors."³⁸⁴ Now the government's main argument,³⁸⁵ duress would come to occupy most of the Court's opinion.³⁸⁶

In terms of the power to limit war profits, the duress theory was a major breakthrough. It applied to any transaction in which the necessity of war led to a large profit. In other words, its coverage was commensurate with the extent of the problem. It was not limited by false pretenses about the parties' states of mind, as was Brown's theory of misrepresentation, nor by result-oriented manipulations premised on the accidental peculiarities of the contract's format, as were the cases in the Court of Claims. The charge of unconscionability had lacked force in the

381. Petition for Writs of Certiorari, *supra* note 336, at 12.

382. *Id.*

383. Govt. S. Ct. Br., *supra* note 220, at 64–67. Before reaching the Supreme Court, the government had never argued duress. However, attorneys did brainstorm the theory before the litigation began. The issue of necessity arose as an offshoot of the trustee theory, Moody, *supra* note 267, at 22; or as a kind of aggravating factor, Parker, *supra* note 233, at 6; or merely as a reason to press the litigation, Adamson, *supra* note 233, at 1. Another attorney briefly mentioned duress, within a laundry-list of charges, in a draft petition for certiorari in September 1939. Draft Petition for Certiorari at 14 (ca. Sept. 1939) (Section 6, DOJ-NA, *supra* note 123).

384. Petition for Writs of Certiorari, *supra* note 336, at 13.

385. The core of the brief focused on duress and unconscionability (with the latter newly argued on the basis of quasi-duress). Govt. S. Ct. Br., *supra* note 220, at 51–85. The Justice Department retained arguments about separate consideration, *id.* at 31–51; public policy, *id.* at 48–49; and the contracting officers' fiduciary duty, *id.* at 85–86. It dropped fraud altogether. However, duress was clearly the main point: in Jackson's handwritten notes for oral argument, the first words under "Theory of Relief" were "War necessity equal duress." Robert H. Jackson, untitled handwritten notes for oral argument in *Bethlehem* case at 3 (Folder labeled "Legal File—Supreme Court O.T. 1941—Cases Nos. 8, 9—U.S. v. Bethlehem Steel Corporation," Box 122, RHJ-LC, *supra* note 22).

386. In the majority opinion in *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942), the discussion of the law took up pages 296–309, of which duress and unconscionability (which the government based on quasi-duress) occupied pages 299–309.

lower proceedings, since it required, except in the most extreme cases, a bargaining defect to authorize judicial intervention. Duress filled the order. It authorized a broad substantive inquiry into every big profit made under necessity, whatever the exact circumstances.³⁸⁷

Of all the government's previous arguments, the sweep of duress was matched only by the theory of contractor-as-trustee—a theory which Frankfurter, the sole Justice to advocate the duress theory, also espoused.³⁸⁸ No longer twisting facts or stretching doctrine to redress the inequity of one or a few cases, the government now invited the judiciary to serve openly as the defense industry's regulator of last resort.

As regulators, courts would need to award profits so as to incentivize cost reduction, optimize investment, and reward risk, much as officials later did under the Renegotiation Act. In keeping with this vision, the Justice Department explicitly rested its claim to relief on certain factual premises: first, Bethlehem's savings bonus did not result from any cost reduction by the firm;³⁸⁹ second, Bethlehem did not expect U.S. war

387. The government argued the duress theory in such a way that a victory would have allowed the theory to be applied subsequently to contracts generally, not merely to savings contracts alone. The government stated that a contract "expressly providing" for a profit comparable to Bethlehem's as a set percentage of actual or estimated cost would be invalid. Govt. S. Ct. Br., *supra* note 220, at 57, 84-85. It added that allowing events beyond Bethlehem's control to confer upon it a profit of twenty-two percent was no different from fixing the profit at that level expressly. *Id.* at 59.

Conceptually, the government did not confine the duress theory to the contract format. In its discussion of the duress claim, *id.* at 63-75, it mentioned the savings format only in incidental ways: first, when discussing what Bethlehem had exacted by duress, *id.* at 64, 71; and second, when stating that in *quantum meruit* (which was the remedy for duress), Bethlehem deserved the fixed fee but not the bonus, *id.* at 74-75. Likewise, in the section discussing unconscionability (which was premised on quasi-duress), every reference to the savings format was conceptually incidental: as the form taken by the inordinate profit, *id.* at 76; or as part of the facts of *Burke & James*, which was cited in this section only for its theory of unconscionability (as part of a series of cases espousing that same general doctrine), not for its theory of separate consideration, *id.* at 77-78. Similarly, in its petition for certiorari, the government, in the first and most-developed of its reasons for granting the writ, discussed profits and necessity broadly and referenced the savings contract only incidentally. Petition for Writs of Certiorari, *supra* note 336, at 12-16. Direct discussion of the savings format was relegated to later sections. *Id.* at 16-18. In a five-page recollection of the case years afterward, Jackson mentioned the savings format only once, when discussing the abandoned theory of misrepresentation, and even this reference he later crossed out. Jackson, *supra* note 257, at 995. His discussion otherwise focused broadly on exploitative bargaining. *Id.* at 995-99.

It appears that Jackson and Frankfurter considered improper cost allowances, which were really concealed profits, relevant to the analysis. In his handwritten notes for oral argument, Jackson noted that the official profits did not include Bethlehem's sale of supplies to its subsidiary. Jackson, *supra* note 385, at 5. Frankfurter mentioned this, as well as the general looseness of the contract's definition of cost. *Bethlehem*, 315 U.S. at 319-20, 323 (Frankfurter, J., dissenting). These comments suggest that the duress theory might later have been applied to recover such allowances, among other forms of exorbitant profit.

388. Frankfurter said it was reasonable to judge large defense contracts "by standards not unlike those by which a fiduciary's conduct is judged." *Bethlehem*, 315 U.S. at 337.

389. Govt. S. Ct. Br., *supra* note 220, at 24-30 (making the factual claim), 57 ("the only justification which has ever been advanced for the bonus-for-savings clause is its alleged value as an incentive for efficiency"), and 75 ("to receive payment beyond its fixed profit" in *quantum meruit*,

contracts when it massively expanded its plant before 1917, meaning that the prospect of profits from such contracts could not have led to its investment decision;³⁹⁰ and third, the profit was not commensurate with the contract's low level of risk.³⁹¹ The third premise was undeniable. The second, judged by the limited fact-finding, was fairly solid.³⁹² The first, however, was contestable, as we have seen.³⁹³ Its contestability typified the uncertainty that always plagued the process of re-pricing after performance—an uncertainty that, under any regime (including the Renegotiation Act), would inevitably entail error costs and administrative costs. Those costs, however, had to be balanced against the benefit of determining prices at a time of improved information and more equal bargaining power.

The Justice Department concluded that the contract was invalid due to duress, meaning that Bethlehem deserved only the fair value of its services. The firm had achieved no more cost reduction, and assumed no more risk, than it would have under a plain CPFF contract. Therefore, it should receive the profit appropriate to such a CPFF contract, no more. The typical CPFF contract for wartime shipbuilding, argued the Department, had a fixed fee of about ten percent, the same as Bethlehem's. So Bethlehem should get only its fixed fee.³⁹⁴

B. GATHERING A QUORUM IN THE SUPREME COURT

Once the Justice Department filed its brief in January 1941, the litigation hit one final snag. Three Justices recused themselves: Stone, because he had supervised the litigation as Attorney General seventeen years earlier; Roberts, because he had served as Master; and Frank Murphy, because he had been Attorney General during the first appeal.³⁹⁵ James C. McReynolds retired that same month, reducing the Court below its quorum of six, so the case had to be postponed.³⁹⁶ Chief Justice Charles Evans Hughes then retired that June. The two vacancies

"Bethlehem must prove that it rendered some service, the value of which is reasonably measured by the compensation claimed. This . . . Bethlehem . . . cannot prove. . . . [T]he difference between the estimated and actual cost of the vessels was not due to any increase of efficiency brought about by Bethlehem's efforts.").

390. *Id.* at 56. The government also argued that the contract did not promise to pay such a subsidy for investment. *Id.*

391. *Id.* at 62–63 ("In determining the amount of profits which can lawfully be exacted from the Government in wartime contracts, regard should be had to the extent of the risk assumed by the contractor"; "Bethlehem" took "no risk of loss whatever").

392. *Id.* at 56 (citing testimony).

393. See *supra* text accompanying notes 241–49.

394. Govt. S. Ct. Br., *supra* note 220, at 74–75.

395. For the names of the Justices recusing themselves, see Memorandum from "RS" to Robert H. Jackson, Attorney General (Jan. 27, 1941) (Folder labeled "Legal File—Attorney General—Bethlehem Steel Case," Box 86, RHJ-LC, *supra* note 22).

396. *Id.*

were filled by James F. Byrnes, who as a Congressman had spurred the Justice Department to press the litigation,³⁹⁷ and Jackson, who was first author of the brief.³⁹⁸ While Byrnes seems never to have considered recusing himself, Jackson had to. Now down to five Justices, the Court could not hear the case. But as mobilization took off, Murphy changed his mind in October and decided to sit.³⁹⁹ Argument was ultimately scheduled for Tuesday, December 9, which turned out to be two days after Pearl Harbor.⁴⁰⁰

C. CORPORATE EXTORTION OF GOVERNMENT AS A NATIONAL POLITICAL ISSUE

By accusing Bethlehem of coercing the government, the Justice Department was entering a heated political debate over the balance of power in business-government relations, an issue central to both World Wars and the New Deal. During that era, the most telling distinction in American political economy was not between Republicans and Democrats, nor even between advocates of laissez-faire and of government intervention. Instead, it was between two different attitudes toward the role of bureaucratic planning in economic life. On one side were those who believed that the rise of large corporate bureaucracies and industrial concentration was a good thing, whether as an end in itself or as a stepping stone toward government administration of the economy. On the opposite side were those who believed that mass administrative organization was damaging to efficiency and dangerous to freedom, and who therefore preferred a decentralized system of economic decision-making. Ellis W. Hawley, in his classic study *The New Deal and the Problem of Monopoly*,⁴⁰¹ labeled the former group "corporatists" and the latter group "antitrusters." The distinction obviously obscures differences of opinion within the two camps, but it does capture the crux of the national debate.

The corporatists defined their program in opposition to the nineteenth-century economic system, in which numerous small businesses competed intensely with one another. This system, in the eyes of the corporatists, had produced too-high output at too-low prices, erased profits (particularly as new technologies created economies of

397. The dispute had been kept confidential until Byrnes broadcast it to the nation. HESSEN, *supra* note 192, at 261-62. In 1924, he took to the House floor and attacked the Attorney General for dragging his feet in bringing the case, accusing him of coziness with Bethlehem directors. [Byrnes] *Asserts Daughtery Favors C.M. Schwab*, N.Y. TIMES, Mar. 15, 1924, at 4.

398. Govt. S. Ct. Br., *supra* note 220, at 87.

399. *High Court Will Hear the Bethlehem Case*, N.Y. TIMES, Oct. 23, 1941, at 38 ("Justice Murphy Decides to Sit."). Murphy said he had "naught to do with the case" as Attorney General. J. WOODFORD HOWARD, JR., MR. JUSTICE MURPHY: A POLITICAL BIOGRAPHY 279 (1968).

400. *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 289 (1942).

401. ELLIS W. HAWLEY, *THE NEW DEAL AND THE PROBLEM OF MONOPOLY* (1966).

scale that raised fixed costs), increased risk, discouraged investment, caused rampant bankruptcies, and created a dangerously volatile business cycle with severe bouts of unemployment. The nightmare finally lifted when, in the late 1800s and early 1900s, industry after industry became concentrated in large corporations whose vast bureaucracies replaced chaos with rationality. Large bureaucracies made marketing possible, empowering the firm to measure and shape demand. And as firms became fewer and larger, it became possible to restrict output so as not to exceed demand. As a result, corporations could maintain high prices, control risk, and invite continuous investment, thus guaranteeing high wages, technological advance, and stable growth. These results could be further assured if industries became concentrated and if executives at different firms openly cooperated with each other to limit output to a rational level. Under this new system, executives would be motivated not by competition, but rather industrial statesmanship. Some of the leading advocates of this position were, not surprisingly, corporate executives themselves, such as Gary of U.S. Steel. These business leaders did not believe in *laissez-faire*. Granted, they wanted to abolish certain forms of government intervention (e.g., antitrust). But aside from that, they wanted the state to actively support inter-firm cooperation and planning. With the establishment of the National Recovery Administration (NRA) in 1933, these executives largely got their wish: the Act empowered each industry to form its own cartel and use the law to enforce the rules of the cartel against recalcitrant firms. This might be called the right-wing version of corporatism. In the left-wing version, the executives, rather than planning the economy on their own, would serve as technocrats to implement the decisions of elected officials. Faith in corporate bureaucratic planning as the key to social welfare united the two versions.⁴⁰²

This was anathema to the antitrusters, who looked back fondly on the nineteenth-century system of competition between small businesses. That system, so they argued, diffused power and thereby preserved the social equality and personal independence necessary to democracy and freedom. At the economic level, the antitrusters believed that small-unit competition benefited everyone because it forced down prices and made goods plentiful, thus raising the purchasing power of all workers. Industrial concentration resulted not from superior efficiency but unfair government favoritism. Giant bureaucracies did not represent a better way of doing business, but were instead instruments by which private persons could manipulate the economy for their own benefit. If an industry became concentrated, the best response was to make it

402. See HAWLEY, *supra* note 401, at 19–280. For a similar, more recent, analysis, see BRINKLEY, *supra* note 16, at 31–47.

competitive again by using the antitrust laws to prevent the abuse of market power and to break up large firms (except in rare cases when bigness really was more efficient, such as public utilities, for which the best response was public ownership or tight regulation to keep prices low).⁴⁰³

To committed antitrusters, it was deeply significant that concentrated bureaucratic power rested largely in the hands of private corporations. This empirical fact, they believed, meant that any kind of economic planning would inevitably serve the interests of those corporations. It was not a stretch to make this prediction about the right-wing version of corporatism, under which executives would simply run the economy as they pleased, with nothing but their supposed good faith to hold them accountable. Yet the antitrusters were similarly wary about the left-wing version of corporatism. While socialist dreamers might envision a world in which corporate technocrats did the bidding of elected officials, the antitrusters recognized that the corporations themselves actually embodied and controlled the vast bureaucracies that made planning possible, which gave them leverage over any officials who attempted to regulate them.

Jackson, the leading voice of the antitrusters in the late 1930s, articulated this point. To begin with, he was suspicious of all bureaucracy. "Bureaucracy or regimentation of any kind is distasteful," he declared in 1938.⁴⁰⁴ "Plain and practical people," he wrote that same year, "have an instinct that a distant and none too well equipped bureaucracy is not an effective or acceptable force to control the mass of detailed transaction necessary to even a simple business."⁴⁰⁵ Besides, regardless of bureaucracy's benefits, American political culture was unlikely to tolerate a big public administrative class. Government regulation of business, Jackson argued, "calls for more foresight in recruiting consistently competent minor public servants and giving them adequate pay and security than the present state of the American political mind is willing to recognize."⁴⁰⁶ The lack of such public servants was fatal, he thought, for regulation "is a fundamental problem of man power." "In practice," he explained, "regulation means complicated and continuous negotiations," and it was foolish to assume that "now or in the immediate future we have or will get, in government, adequate numbers of adequate men to represent the public interest in those

403. HAWLEY, *supra* note 401, at 280-379; see also BRINKLEY, *supra* note 16, at 48-64.

404. Robert H. Jackson & Edward Dumbauld, *Monopolies and the Courts*, 86 U. PA. L. REV. 231, 237 (1938).

405. Robert H. Jackson, *Financial Monopoly: The Road to Socialism*, FORUM, Dec. 1938, at 303, 304.

406. *Id.* at 307.

negotiations.”⁴⁰⁷ Contrary to what corporatists believed, the government could not tame or use corporations without itself possessing the massive bureaucratic machinery required to monitor and hold them accountable. “It is naïve,” Jackson attested, “to suppose that a few public representatives in an industrial conference, by the sheer force of their moral or intellectual suasion, will be able to stand up against the resourcefulness and power which private enterprise can command.”⁴⁰⁸ Corporatism would be “little more than the legal sanctification of the *status quo*” of ever-increasing corporate power.⁴⁰⁹ The government, in the eyes of Jackson and his colleagues, should refuse to take part in the corporations’ game of bureaucratic endeavor, whether as a partner or as a supervisor, for it was not equal to the task, and in doing so, it opened itself to capture and exploitation by private interests.

Total war was central to the controversy between corporatists and antitrusters. Whatever their political beliefs, everybody had to admit the impossibility of national mobilization without mass administrative coordination. Modern warfare obliged the government to take advantage of all existing bureaucratic capacity and, therefore, to cooperate with corporations. To corporatists, this was a terrific opportunity. The government’s hour of need gave businessmen the chance to run the economy in the rational fashion they had always known to be best. For decades after World War I, advocates of industrial cooperation cited the effort of 1917–1918 as the model of how the economy should work: executives of different firms, motivated by patriotic statesmanship rather than competition, conferred with each other to avoid waste and calibrate output to the demand of the consumer, in this case the government, with high prices and high profits encouraging investment in needed additional capacity.⁴¹⁰ Indeed, when the NRA took power in 1933, it modeled itself on Baruch’s WIB and presented its program as a kind of war effort.⁴¹¹

Antitrusters conceded that total war necessitated some government partnership with the business bureaucracy. Rather than a grand social experiment, however, the antitrusters considered this a serious danger. Many antitrusters wanted to avoid it at any cost, and so they turned to isolationism. For antitrusters like Jackson who embraced internationalism, total war still involved a painful violation of their beliefs. “[A] war economy,” Jackson once declared, “is completely at

407. *Id.*

408. *Id.*

409. *Id.*

410. See KENNEDY, *supra* note 50, at 134–35 (noting WIB mentality of high prices and profits for high production).

411. See William E. Leuchtenburg, *The New Deal and the Analogue of War, in* CHANGE AND CONTINUITY IN TWENTIETH-CENTURY AMERICA 81, 120–22 (John Braeman et al. eds., 1964).

odds with the free economy that is implied in free competition."⁴¹² The antitrusters subjected wartime corporatism to a double critique. First, it was bad policy: though corporatists professed that high prices were necessary to cover increased costs and new investment, big contractors were in fact taking advantage of market power to put more money in the pockets of their executives and shareholders.⁴¹³ Second, corporatism was implemented by undemocratic means: war contractors, exploiting their monopoly power over much-needed management capacity, forced the policy on the rest of the country. Corporatism's dominance in World War I did not reflect its effectiveness or popularity, but merely the public's acquiescence in the face of concentrated power. Antitrusters repeatedly compared corporations with robbers and striking workers (a group often condemned for coercive tactics). If the government had to rely on private steel companies in a future war, warned the Southern populist Benjamin Tillman, it would "be unmercifully robbed."⁴¹⁴ The prices ultimately paid to those firms, declared Mississippi Senator James K. Vardaman in 1917, amounted to a "hold-up pure and simple."⁴¹⁵ The wartime practices of steel and copper companies, fumed North Dakota Senator Gerald P. Nye in 1935, constituted a "strike," one "carried on behind closed doors," in which the firms "won higher profits as a result of their delay." That same year, Nye's committee cited a wartime "strike of capital," defined as "the use by business of its power of forcing price concessions from the Government by making that a condition of continued production."⁴¹⁶

The Depression, from the antitrusters' perspective, provided a similar opportunity for business to extort the government. Elected officials needed immediate production to lift their constituents out of poverty, and to get it in the short term, they had to induce business to cooperate. When executives conditioned renewed production on profit-friendly policies, they were again denounced as robbers and strikers. Roosevelt himself privately indulged in this rhetoric. Speaking to a colleague in 1937, he postulated "that business was deliberately causing the depression in order to hold a pistol to his head and force a retreat from the New Deal."⁴¹⁷ Later that year, Jackson, in a national radio address that made him famous, responded to business demands for government cooperation by announcing, in an apparently unconscious echo of Nye, that the nation faced a "strike of capital."⁴¹⁸ It was "a

412. Jackson, *supra* note 257, at 830.

413. A good example of this argument can be found in *Prices and Social Policy*, NEW REPUBLIC, Feb. 17, 1941, at 243. This question was also debated between Bethlehem President Eugene Grace and the Nye Committee. See *Nye Hearings*, *supra* note 143, at 5746, 5751-52, 5754-59.

414. UROFSKY, *supra* note 28, at 133 (citation omitted).

415. *Id.* at 205 (citation omitted).

416. *Nye Comm. Report*, *supra* note 61, at 94.

417. HAWLEY, *supra* note 401, at 389 (citation omitted).

418. Robert H. Jackson, *The Menace to Free Enterprise*, Address to the American Political

general strike—the first general strike in America—a strike against the government—a strike to coerce political action.”⁴¹⁹ “Uncle Sam” was being “told to stick up his hands and deliver over his utilities program, his monopoly program, his social security program and his tax program to one or another interested group.”⁴²⁰

Lest Americans forget the true meaning of what big business was asking for, Jackson reminded them of the corporatist experiment of 1917–1918. The war, he explained in another national radio address that same week, was “one of the most notable instances of cooperation between government and big business, on the latter’s own terms.”⁴²¹ The results, as Jackson recounted them, were grim:

[There were] almost continuous appeals by President Wilson and by the [War Industries] Board itself to big business to keep prices down so that goods might continue to flow to the trenches and among the home population on whose activities production depended. Meanwhile, as the Government’s contribution to cooperation, anti-trust prosecution was abandoned, the government paid for its purchases pretty much what was asked and general prices were fixed at profiteering levels, because big business would not “cooperate” on any other terms. The results of that cooperation were a further stride toward monopoly by the biggest aggregations of capital in American industry and a *ghastly waste of the nation’s money under pressure of war*.⁴²²

As they had in the war, so now in the Depression, corporations were “profiteering at the expense of national recovery.”⁴²³ The war experience was a standing warning against corporatism: “What big business has previously done in the name of ‘cooperation’ is too well remembered for us to commit ourselves to it again in the dark.”⁴²⁴

Although the nation did not commit itself to corporatism in 1937, it could hardly resist in 1940, with the rising Axis threat and the immediate need for large war contracts. As Roosevelt recruited business executives for the new National Defense Advisory Council (NDAC), liberals sensed the return of corporatism. “With the possible exception of the NRA,” warned one journalist, “the NDAC represents the greatest concentration of big-business influence ever seen in Washington.”⁴²⁵ “[M]ost of the old NRA gang,” worried John T. Flynn, a former associate of Nye, “are

Science Association 2 (Dec. 29, 1937) (Folder labeled “Subject File—‘Strike of Capital,’” Box 30, RHJ-LC, *supra* note 22).

419. *Id.*

420. *Id.* at 3.

421. Robert H. Jackson, Business Confidence and Government Policy, Address for Broadcast Over the Mutual Broadcasting System 3 (Dec. 26, 1937) (Box 200, Raymond Clapper Papers, Manuscripts Division, Library of Congress, Washington, D.C.).

422. *Id.* (emphasis added).

423. *Id.* at 5.

424. *Id.* at 3.

425. Jonathan Mitchell, *Is Our Defense Lagging?*, NEW REPUBLIC, Aug. 26, 1940, at 265, 267.

moving in on Washington under the banner of national defense."⁴²⁶ In exchange for taking on the risky enterprise of war production, contractors were demanding more business-friendly financial rules for contracts, lower profits taxes, and the relaxation of antitrust enforcement. "[T]he industrialists in whose plants our war materials are to be manufactured," announced the *New Republic*, "believe that they can drive a hard bargain."⁴²⁷ Again came the accusations of a hold-up and a strike. Bruce Bliven asked whether "we have reached a point where any industry can hold up the government of the United States at the point of a blackmail letter."⁴²⁸ I.F. Stone denounced the "Sitdown Strike of Capital,"⁴²⁹ while the *New Republic* ran the headline, "Arms Makers' Sit-Down."⁴³⁰

These coercive tactics, as liberals saw it, yielded handsome returns for business. The chief of the Antitrust Division, Thurman W. Arnold, reported to Jackson in early 1940 that "certain large business interests are in a position to take advantage of . . . the Government . . . when the war expenditures program gets well under way."⁴³¹ Despite this warning, antitrust prosecution eventually became a "casualty of the war effort."⁴³² Further, Congress overhauled the tax system in the Second Revenue Act, passed on October 8, 1940. In the key industries of shipbuilding and aviation, the Act scrapped the absolute caps on profit as a percentage of cost that had governed defense contracts since the mid-1930s.⁴³³ In place of these caps, Congress adopted a graduated tax ostensibly designed to control gains from defense. The Roosevelt administration had pushed for a relatively tough law, but when Congress proved reluctant to pass a tax during an election year, and key committee members stubbornly defended the interests of major firms, the President took what he could get.⁴³⁴ In its final form, the Act allowed companies a choice of how to calculate defense profits, creating a huge loophole. Although taxation was inherently limited as an instrument to control war profits, the

426. John T. Flynn, *Other People's Money: One-Man Fight*, NEW REPUBLIC, Oct. 28, 1940, at 585, 585.

427. *Business and Blackmail*, NEW REPUBLIC, Sept. 2, 1940, at 295, 295.

428. Bruce Bliven, *Get Tough, Mr. President!*, NEW REPUBLIC, Sept. 16, 1940, at 377, 378.

429. I.F. STONE, BUSINESS AS USUAL 157 (1941).

430. T.R.B., *Arms Makers' Sit-Down*, NEW REPUBLIC, Sept. 9, 1940, at 351.

431. Letter from Thurman Arnold, Assistant Attorney General, to Robert H. Jackson, Attorney General (Jan. 15, 1940) (Folder labeled "Legal File—Attorney General—Antitrust Activities—War Materials Industries," Box 85, RHJ-LC, *supra* note 22). On Arnold's conviction that antitrust law was necessary to protect the government in wartime, see Thurman W. Arnold, *Antitrust Activities of the Department of Justice*, 19 OR. L. REV. 22 (1939); Thurman Arnold, *Defense and Restraints of Trade*, NEW REPUBLIC, May 19, 1941, at 686; *War Monopolies*, NEW REPUBLIC, Oct. 14, 1940, at 512.

432. HAWLEY, *supra* note 401, at 440–42.

433. WADDELL, *supra* note 31, at 55–57; *Excess Profits Sham*, NEW REPUBLIC, Oct. 7, 1940, at 467, 467–68.

434. BRANDES, *supra* note 26, at 243–44.

weakness of this statute was especially striking. U.S. Steel more than doubled its profits in 1940 but avoided the tax completely.⁴³⁵ Bethlehem, soon to become the nation's biggest defense contractor,⁴³⁶ received more than a billion dollars in defense money by the end of 1940.⁴³⁷ It saw its annual profits jump from \$19 million to \$48 million, yet the tax cost it only \$1 million.⁴³⁸

Some defended this type of policy as a necessary compromise to jump-start the war effort. "If you are going . . . to prepare for war in a capitalist country," wrote Secretary of War Henry Stimson, "you have got to let business make money out of the process or business won't work."⁴³⁹ To liberals, it was a crushing defeat. The Act, complained one commentator, was "one of the most shameless pieces of lobby-written legislation passed in many years."⁴⁴⁰ It wrote "profiteering into law."⁴⁴¹ The *New Republic* branded it a "Sham."⁴⁴² The economist George Soule called it a "joke."⁴⁴³ Jackson, as a member of the cabinet, held his tongue. Years later, however, he recalled how Roosevelt had been "obliged to appeal for the cooperation of business men" at immense cost.⁴⁴⁴ "As we moved into a war economy," he remembered, "the anti-trust policy [and] taxation . . . were moving in a direction that I didn't like. I wasn't happy in the situation."⁴⁴⁵

Corporations' exploitation of their wartime bargaining power against the government, then, was a big issue for Jackson. The duress theory in the *Bethlehem* appeal translated this political theme into a legal argument, right down to the problem's origin—the inequality of bureaucratic capacity. The Third Circuit and the Master, after all, both stated that the EFC could not accomplish its mission without Bethlehem's existing organization.⁴⁴⁶ This created the opportunity for, as the antitrusters would say, a hold-up. Indeed, Jackson put the problem in exactly these terms when he looked back on the case years later. Picking up on Dickinson's image of Bethlehem's conduct as "daylight robbery" without deception,⁴⁴⁷ Jackson stated: "My proposition was a very simple

435. Max Gissen, *Tax Excess Profits!*, NEW REPUBLIC, June 2, 1941, at 755; E.D. Kennedy, *War Profits: The Case of Steel*, NEW REPUBLIC, Oct. 27, 1941, at 529, 529.

436. Higgs, *supra* note 21, at 186.

437. Robertson, *supra* note 98, at 781.

438. *What Excess Profits Tax?*, NEW REPUBLIC, Jan. 6, 1941, at 4.

439. Henry Stimson, *Diary* (Aug. 26, 1940), *quoted in* KENNEDY, *supra* note 62, at 622.

440. Gissen, *supra* note 435, at 755.

441. *Id.*

442. *Excess Profits Sham*, *supra* note 433, at 467.

443. George Soule, *The Fear of Plenty*, NEW REPUBLIC, Mar. 31, 1941, at 425, 425.

444. Jackson, *supra* note 257, at 966.

445. *Id.* at 965–66.

446. *United States v. Bethlehem Steel Corp.*, 113 F.2d 301, 305–06 (3d Cir. 1940); Master's Report, *supra* note 174, at 539.

447. *Bethlehem*, 23 F. Supp. at 679.

one—that you can no more rob the government than you can deceive it.”⁴⁴⁸ He elaborated: “At a time when the government was engaged in a war and under the utmost necessity for production, and this corporation had the facilities which the government didn’t have, to hold it up in that fashion was not only morally wrong, but a legal wrong.”⁴⁴⁹

The sources do not disclose which attorney in the Justice Department first pushed the idea of arguing duress.⁴⁵⁰ Whoever it was, the theory resonated strongly with Jackson’s politics, and so he essentially stepped out of his role as Attorney General and made himself Solicitor General for the purpose of the appeal, signing his name first on the brief and planning to handle the oral argument personally.⁴⁵¹ In his handwritten notes for that argument, under the heading “Theory of Relief,” the first words were: “War necessity equal duress.”⁴⁵² The Supreme Court’s rejection of the government’s case crushed Jackson. Admitting that he was “damned prejudiced” about the matter, he wrote to Douglas that “I cannot understand the decision of the court in this case. I really regard it as the dirtiest day’s work the Court has ever done and a defeat for the Government worse than Pearl Harbor.”⁴⁵³ Years afterward, he said it “was one of the shocks of my experience on the Court that this case was treated that way. I never got over it.”⁴⁵⁴

It may seem odd that Roosevelt allowed his Justice Department to try to control contractors’ profits through the courts, even as he acquiesced in the generous profit policies of Congress. Pointing out the inconsistency, a conservative journalist lamented that the “left hand doesn’t know what the right hand is doing in Government today.”⁴⁵⁵ However, Roosevelt often allowed his subordinates to pursue contradictory policies at the same time, waiting to see which worked best. As the President himself once quipped, “I never let my right hand know

448. Jackson, *supra* note 257, at 997.

449. *Id.*

450. It may have been Warner W. Gardner. In 1939, he was first assistant to Solicitor General Jackson. Warner W. Gardner, *Government Attorney*, 55 COLUM. L. REV. 438, 438 n.* (1955). In a draft petition for certiorari written that year, he extensively developed the argument that the *Bethlehem* contract was invalid due to “overreaching by the contractor while the Government was under duress of the necessities of the national emergency.” Untitled draft petition for certiorari 12 n. (ca. Sept. 1939) (Section 8, DOJ-NA, *supra* note 123). For Gardner’s authorship of the draft, see the handwritten cover note: “This draft represents something of the approach I would prefer,” signed “WWG.” *Id.*

451. Govt. S. Ct. Br., *supra* note 220, at 87; Jackson, *supra* note 257, at 998.

452. Jackson, *supra* note 385, at 2.

453. Letter from Justice Robert H. Jackson to Justice William O. Douglas, *supra* note 22.

454. Jackson, *supra* note 257, at 999.

455. David Lawrence, *Today in Washington*, newspaper clipping without publication title (Sept. 14, 1940) (Folder labeled “Legal File—Attorney General—Bethlehem Steel Case,” Box 86, RHJ-LC, *supra* note 22).

what my left hand does.”⁴⁵⁶

D. A NEW UNDERSTANDING OF DURESS

Hold-up, robbery, necessity, strike, pressure of war—these rhetorical shafts drew their force from one of the foundational distinctions in American culture: the difference between freedom and coercion. In political debate, this distinction possessed an obvious, even visceral, intuitive meaning. But as a matter of law, it was a slippery, indeterminate doctrine, not necessarily suited to the Justice Department’s needs. In its brief, the Justice Department re-shaped the doctrine into something new.

Before the modern era, duress had no independent meaning. It was an appendage of crime and tort: if someone made a promise under threat of conduct that was itself criminal or tortious, the courts would not enforce it. Initially confined to threats of physical harm, this variety of duress was extended in the 1700s to threatened economic harm, so long as it was unlawful in itself.⁴⁵⁷ Duress might have retained this narrow scope had Chancery not invented a related doctrine called undue influence. In cases of undue influence, judges refused to enforce promises extracted via threats (including economic ones) against persons who were elderly, weak, or vulnerable in some other way.⁴⁵⁸ Significantly, the finding of coercion did not require the threatened conduct to be unlawful in itself. If a man threatened to do what he otherwise had a legal right to do, his threat might still be actionable, depending on the subjective effect of the threat on the other party. At the time it was invented in the 1600s and 1700s, undue influence was not especially groundbreaking; it was just another paternalist limit on the capacity to contract.

However, because undue influence switched focus from the legal status of the threatened act to the mental state of the victim, the doctrine fit nicely with nineteenth-century liberalism. In the liberal view, the end of feudalism meant the breakdown of rigid, ascriptive power relations. In their place came market society, a domain of social fluidity in which personal will and initiative went unconstrained. In this world, a contract came about because each party, free to do as it chose, affirmatively wanted to make the agreement. In this context, undue influence came to be understood more broadly as “the interference with another’s will, which should ideally be free. The test for the existence of undue influence became . . . whether or not the individual will had been ‘overpowered.’”⁴⁵⁹ Thus redefined, undue influence fused with duress

456. BRANDES, *supra* note 26, at 232 (citation omitted).

457. John P. Dawson, *Economic Duress—An Essay in Perspective*, 45 MICH. L. REV. 253, 254–62 (1947).

458. *Id.* at 262–63.

459. *Id.* at 263.

when the barrier between law and equity crumbled in the late 1800s. The purpose of the unified doctrine was to protect free will.⁴⁶⁰

Essentially psychological, the new definition officially held sway well into the twentieth century. The Pennsylvania Supreme Court declared in 1912 that the "test of duress is not so much the means by which the party was compelled to execute the contract as it is the state of mind induced by the means employed—the fear which made it impossible for him to exercise his own free will."⁴⁶¹ This rule was quoted by the *Corpus Juris Secundum*, published in 1917 and cited by courts for decades afterward.⁴⁶² Earl C. Arnold, later the Dean of Vanderbilt Law School,⁴⁶³ quoted it when writing in the *University of Pennsylvania Law Review* in 1928 to back up the premise that "duress is now viewed subjectively."⁴⁶⁴ "The trend of the modern decisions," wrote a student in 1941, was to ask, "Was the free agency or will power of the duressee subverted or coerced by the conduct of the duressor?"⁴⁶⁵ Another student, commenting on the *Bethlehem* appeal, explained that the purpose of economic duress was to restore payments "made by one who was in fact deprived of his will."⁴⁶⁶

Despite the prevalence of the free-will psychology, the Justice Department argued duress in a manner that eschewed that principle. The brief never used the terms *will*, *consent*, *voluntary*, *involuntary*, *agency*, *volition*, *overcome*, *deprive*, or any other subjective psychological terms.⁴⁶⁷ With respect to the question of coercion, the government never mentioned the state of mind of any official.⁴⁶⁸ Rather, the duress argument focused solely on the objective, external economic circumstances surrounding the EFC. To go without the ships would put the war effort in jeopardy; to seize the plant would undermine efficiency and likewise damage the war effort. Hence, the EFC had "no choice but to accept whatever terms Bethlehem insisted upon."⁴⁶⁹ It was thereby

460. *Id.* at 265.

461. *Fountain v. Bigham*, 84 A. 131, 135 (Pa. 1912).

462. See *Central Acceptance Corp. v. Nash Bluefield Motor Co.*, 139 S.E. 654, 656 (W. Va. 1927) (citing 13 C.J.S. § 319 (1917)); see also *Slade v. Slade*, 33 N.E.2d 951, 954 (Ill. App. Ct. 1941); *Coleman v. Crescent Insulated Wire & Cable Co.*, 168 S.W.2d 1060, 1066–67 (Mo. 1943) (citing 17 C.J.S. *Contracts* § 175).

463. See Earl C. Arnold, Book Review, 24 CORNELL L.Q. 298, 299 (1939).

464. Earl C. Arnold, *Availability of Duress and Fraud upon the Principal as Defenses to the Surety and Guarantor*, 77 U. PA. L. REV. 23, 28 n.20 (1928).

465. Lyndon Sturgis, Comment, *Duress: A Double Concept*, 6 MO. L. REV. 73, 75 (1941).

466. Bernard Stolbun, Comment, *Economic Duress and Contractual Liability—The Bethlehem Shipbuilding Case*, 21 TEX. L. REV. 56, 63 (1942).

467. These terms are absent from the duress argument in *Govt. S. Ct. Br.*, *supra* note 220, at 63–75.

468. The Justice Department did discuss how Piez relied on Powell for judgment about ships, but this was to show that he could not make an independent judgment about the fairness of the price, meaning that Powell's letter to him was meaningless. This had nothing to do with the question of whether any official was coerced to do anything. *Id.* at 65 n.19.

469. *Id.* at 63; see also *id.* ("no alternative"); *id.* ("without alternative choice"); *id.* at 65 ("no real freedom to reject"); *id.* at 66 ("compelling circumstances"); *id.* at 66 ("a real choice").

“forced to make” the contract at Bethlehem’s price.⁴⁷⁰ “[W]hen the life of the nation is at stake,” explained the brief, “the Government officials charged with the responsibility of securing necessary ships and material cannot refuse to enter into contracts simply because the demands are unreasonably high.”⁴⁷¹ This was not a normal market transaction, in which “both buyer and seller have freedom to refuse.”⁴⁷² These circumstances formed the basis for the lower courts’ “findings of compulsion” and confirmed the “coercive effect” of the transaction.⁴⁷³

One might argue, of course, that the invocation of objective economic circumstances was nothing new in the law of duress. While courts typically emphasized the deprivation of free will, their unspoken test for such deprivation often turned on just how desperate the circumstances seemed to be.⁴⁷⁴ But even so, the very fact that judges cast an evaluation of market circumstances as a supposedly categorical determination about one party’s mental state was itself significant: this rhetoric allowed courts to avoid openly setting bounds on permissible market action. It allowed them to avoid the appearance of regulating. But the Justice Department refused to play the game of analyzing states of mind. Instead, it exposed the systemic market failure of wartime for what it was.

The true evil that came of this market failure, as the Justice Department explained it, was not interference in the mental process by which some party exercised its will, but the substantive maldistribution of resources—the flow of public money into private hands for nothing in return. As a preface to its duress argument, the Justice Department spent twelve pages trying to show that Bethlehem’s profits were “inordinate” in light of such factors as cost reduction, investment incentives, and risk.⁴⁷⁵

We cannot be certain of the intellectual sources of the Justice Department’s theory, since the drafting attorneys’ notes have not survived. Significantly, however, law professors in the 1920s and 1930s had developed striking new theories of freedom, coercion, and duress. Especially important was Robert L. Hale’s work on the practical meaning of coercion, which in turn motivated John P. Dawson to

470. *Id.* at 63; *see also id.* at 66 (contract “imposed” on the EFC); *id.* at 74 (“exacted by the force of a national emergency”).

471. *Id.* at 66–67; *see also id.* at 66 (“could not refuse to enter into the contracts”); *id.* at 67 (“circumstances which in fact make refusal impossible”).

472. *Id.* at 67.

473. *Id.* at 66, 68; *see also id.* at 68 (“moral compulsion”); *id.* at 69 (“compulsion”); *id.* at 70 (“compulsion of an overriding national emergency”). The word “coercion” was used only once, in the instance cited in the text above.

474. *See* the cases summarized in Annotation, *Doctrine of “Business Compulsion,”* 79 A.L.R. 655, 658–68 (1932).

475. Govt. S. Ct. Br., *supra* note 220, at 51–63.

reformulate the doctrine of duress. We know that the Justice Department attorneys drafting the brief had read Dawson's work on duress,⁴⁷⁶ and the influence of both scholars seems evident throughout the document.

Let us begin by considering Hale's ideas. One of the first professional academics accredited in both law and economics, Hale taught at Columbia from the 1910s through the 1940s. He was basically a Lockean individualist, but "of a sort unrecognizable to traditional liberals," since he insisted on "a functional definition of autonomy."⁴⁷⁷ Traditional liberals posited a private sphere of property and contract in which all persons enjoyed liberty to do as they pleased, liberty being defined negatively as the lack of private coercion and governmental constraint. But Hale, in a 1923 article, argued that this supposedly free private sphere was necessarily pervaded by coercive governmental power. When the government protects property, as Hale put it, "[p]assively, it is abstaining from interference with the owner when he deals with the thing owned; actively, it is forcing the non-owner to desist from handling it, unless the owner consents."⁴⁷⁸ Laissez-faire advocates might counter that the state's use of force merely prevented the non-owner from using force against the owner. But that was not accurate, argued Hale, for "the non-owner is forbidden to handle the owner's property even where his handling of it involves no violence or force whatever."⁴⁷⁹

Bargaining, the cornerstone of the market system, was inherently coercive, since each party's ultimate recourse was to walk away from the deal—to exercise the power, backed by state coercion, of forcing the other party not to use the resources bargained for. This was key. A worker who owns no productive property "must eat. While there is no law against eating in the abstract, there is a law which forbids him to eat any of the food which actually exists in the community."⁴⁸⁰ That law is the law of property, which "compels [the worker] to starve if he has no wages, and compels him to go without wages unless he obeys the behests of some employer. It is the law that coerces him into wage-work under penalty of starvation."⁴⁸¹ Of course, coercion is a two-way street, since the employer's "fear that [workers] will exercise the threat to work elsewhere" causes the employer to increase wages, and in so doing, "he

476. See *id.* at 67 (citing Dawson's work).

477. FRIED, *supra* note 1, at 7 (referring to early twentieth-century progressives generally, of which Hale is Fried's chief example).

478. Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470, 471 (1923).

479. *Id.*

480. *Id.* at 472.

481. *Id.* at 473.

submits by so much to [the workers'] wills."⁴⁸²

Having demonstrated that "nearly all incomes are the result of private coercion," Hale concluded that "to admit the coercive nature of [a] process" should not be "to condemn it."⁴⁸³ Traditional liberals thought in terms of categories: freedom (good), coercion (bad). Hale, by contrast, defined freedom functionally as the power to actually do one thing or resist doing another, and so he recognized that freedom for some people typically entailed constraints on other people. Freedom was not a neutral default that the government violated through regulation, but rather a scarce resource that any government necessarily had to choose to distribute in some way. To take away the owner's control of a factory and hand it over to a state official "would neither add to nor subtract from the constraint which is exercised with the aid of the government. It would merely transfer the constraining power to a different set of persons. It might result in greater or in less actual power of free initiative all around," but that was an empirical question.⁴⁸⁴ Whether a system of laissez-faire "would be more or less 'free' (in the sense of giving people greater power to express their wills) than would a state of communism, depends largely on the economic results of communism respecting the character of factory work."⁴⁸⁵ The "economic results" of the system and the "character" of the work were paramount because they decided how much actual, positive power/freedom each individual would possess.

In the liberal concept of economic duress, all market action was voluntary unless taken under pressure of threats that overcame the will. Under Hale's view of the market, this definition made no sense. What did "voluntary" mean? Say that it simply meant that the person willed to do the act. This definition was over-broad: a person still willed to do an act even when motivated by the threat of bad consequences for not doing it. Indeed, the person willed to do the act with *more* alacrity the more terrifying the consequences of failing to act.⁴⁸⁶ Say instead that "voluntary" meant the person had every desire to do the act, and no desire not to do it. That definition captured a much narrower range of market action than liberal theory would have it, for market actors almost never got *exactly* the price they wanted. Indeed, if a firm got the price it asked for, it regretted not having demanded a more favorable price. From Hale's perspective, the very essence of a market decision was that it took place within a matrix of pressures exerted by the various parties. The relevant issue, then, was the economic situation and the set of

482. *Id.* at 474.

483. *Id.*

484. *Id.* at 478.

485. *Id.*

486. Robert L. Hale, *Force and the State: A Comparison of "Political" and "Economic" Compulsion*, 35 COLUM. L. REV. 149, 149-50 (1935).

alternatives, consequences, and pressures that it entailed, not the specious, pseudo-psychological question of whether an act was "voluntary."

This shift in focus fit with the Justice Department's fixation on objective market circumstances. The "full use of Bethlehem's facilities," it explained, was "vital" to the "prosecution of the war,"⁴⁸⁷ meaning that the government effectively lost the option to withhold its business—the primary source of power for any bargainer. This made the "situation quite different from that of the private concern which seeks the construction of ships, or the performance of other business contracts."⁴⁸⁸ For the private firm, "the need for the ships is purely economic; if the contractor demands too much, the owner will have no desire for the ships, for his opportunities of profit will vanish as the cost of the ship goes up."⁴⁸⁹ This creates an "automatic limit to the price upon which the contractor can insist."⁴⁹⁰ That limit did not exist in a large war transaction; the contractor possessed "unqualified power to exact such terms as he chooses."⁴⁹¹ This "unqualified power" got closer to the true issue than did the voluntary or involuntary nature of the weaker party's decision.

Was there a way to invoke this issue within the existing framework of the common law? Mainstream commentators had, at the very least, sensed the inadequacy of "free will" as a rule of decision. Consider the *Restatement (First) of Contracts*, published in 1932. On the one hand, it trumpeted the will theory: "The test of what act or threat produces the required degree of fear is not objective. . . . The question is rather, did it put one entering into the transaction in such fear as to preclude the exercise by him of free will and judgment."⁴⁹² However, the *Restatement* added that the preclusion of free will was not enough for duress unless, on top of that, some act or threatened act of the duressor was "wrongful" in some objective way.⁴⁹³ A wrongful act might be criminal or tortious, or merely "wrongful in a moral sense."⁴⁹⁴ Admitting that it was "impossible to enumerate all conceivable kinds of wrongful acts," the authors included a residual category of "other wrongful acts" at the end of their definition of duress.⁴⁹⁵ Similarly, Samuel Williston, in the 1936–1938 edition of his treatise, made a sweeping declaration of the will theory:

487. Govt. S. Ct. Br., *supra* note 220, at 64.

488. *Id.* at 66.

489. *Id.*

490. *Id.*

491. *Id.*

492. RESTATEMENT (FIRST) OF CONTRACTS § 492 cmt. a (1932).

493. *Id.* § 492 cmt. g. The illustrations make clear that the *Restatement* is referring to wrongfulness both of acts and threatened acts.

494. *Id.*

495. *Id.* § 493 & cmt. a.

"The real and ultimate fact to be determined in every case is whether or not the party really had a choice—whether 'he had his freedom of exercising his will.'"⁴⁹⁶ Yet he added that the "pressure must be wrongful, and not all pressure is wrongful."⁴⁹⁷

The Justice Department might have argued that Bethlehem's threat, i.e. to not enter into the contract, violated a patriotic duty and was therefore "wrongful in a moral sense." A court's acceptance of this stance would have required an awkward judicial innovation, since the determination of which firms were obligated to serve the government during wartime was accorded by statute to the executive, through its power to issue production orders or seize firms. For a judge to impose a duty on a contractor to accept a war order, even when the executive had not officially mandated such acceptance, would cut against the common law aversion to general affirmative duties. Refusal to participate in the war effort was nonfeasance, not malfeasance.⁴⁹⁸

The lack of a wrongful threatened act placed the transaction within a special class of duress cases that the authorities had trouble explaining. These were the cases, as Williston put it, where "a party is constrained to enter into a transaction . . . by force of circumstances for which the other party is not responsible."⁴⁹⁹ The difficulty was obvious: the only threatened act by the "other party" in such a case would be not to enter the contract, which, in a free market, could not be wrongful. "[C]ertainly," cautioned Williston, "there is no broad doctrine forbidding a person from taking advantage of the adversity of another to drive a hard bargain."⁵⁰⁰ Yet, if the desperate circumstances were "known and advantage taken of them by the other party[,] a degree of pressure which would not ordinarily amount to duress, *might* have such coercive effect as to invalidate a transaction."⁵⁰¹ The "might" was an unsatisfying hedge.

496. SAMUEL WILLISTON & GEORGE J. THOMPSON, A TREATISE ON THE LAW OF CONTRACTS (rev. ed. 1936-1938) § 1603 (quoting *Joannin v. Ogilvie*, 52 N.W. 217, 218 (Minn. 1892)). For criticism of Williston's confusion between subjective and objective notions of duress, see John Dalzell, *Duress by Economic Pressure I*, 20 N.C. L. REV. 237 n.3 (1942).

497. WILLISTON & THOMPSON, *supra* note 496, § 1606.

498. The general common law principle was that nonfeasance was not actionable. Granted, the issue here is not whether nonfeasance was itself actionable, but whether a contract based on a threat of nonfeasance was enforceable. The *Restatement (First) of Contracts*, in explaining the wrongfulness element of duress, made a distinction between (1) threats of acts that were both wrongful and actionable, and (2) threats of acts that were wrongful yet not actionable, but which the courts would not permit parties to use to induce others to enter contracts. The examples given in the *Restatement*, however, show that the authors were thinking of affirmative acts, not refusals to act. Examples included threats to expose a cheater at cards, to use one's influence with bankers to stop the victim from getting a loan, and to expose the victim's drinking habits. See *RESTATEMENT (FIRST) OF CONTRACTS* § 493 illus. 17-19 (1932).

499. WILLISTON & THOMPSON, *supra* note 496, § 1608.

500. *Id.* § 1618.

501. *Id.* § 1608 (emphasis added).

Besides, as Hale showed, a term like "coercive effect" was conclusory. As for what really decided these cases, Williston had no answer.

The true meaning of duress in these cases had nothing to do with the voluntary or involuntary nature of the desperate party's assent, for a party desperate to prevent some terrible evil very much needs and wants to undertake all transactions necessary to avert it. That the party felt pressure to make the agreement did not distinguish the case, for market transactions by their very nature are made under pressure. Perhaps, then, the *high level* of pressure made for duress. Even that was not right, for surely there was no duress when a party, under immense pressure to buy some service, contracted for it *at a fair price*. Only in the case of an unfair price would the court annul the transaction. In other words, in cases like these, the defining element of duress was the substantive unfairness of the exchange, not its procedural trappings (voluntariness, wrongful threat, etc.). The defining characteristic that covered all cases of duress was not the type or level of pressure, but rather the use of that pressure for distributive ends that the court considered unfair.⁵⁰²

This explanation of economic duress fit with Hale's concept of the market, for, rather than rely on the presence of overpowering pressure (which, by definition, was present in every bargain), it looked to the substantive ends for which the strong party used that pressure. The first scholar to posit this price-based explanation was Dawson, who was, not surprisingly, a follower of Hale. "Any discussions in the field of economic duress," thought Dawson, "must start" from Hale's thesis.⁵⁰³

Significantly, Dawson did not start out studying duress or coercion. Rather, he had written a series of articles on the role of the monetary system in contract law, especially the way courts dealt with contracts that tilted out of balance due to inflation.⁵⁰⁴ These studies made Dawson especially sensitive to the issue of fair exchange. When he turned his attention to duress in the late 1930s, he saw the same issue at stake. In a 1937 article entitled *Economic Duress and the Fair Exchange in French and German Law*, he argued that the "problem of economic duress cannot be divorced from the larger problem of the fair exchange."⁵⁰⁵ The article showed that French and German courts invoked duress more

502. This point is implicit in John P. Dawson, *Economic Duress and the Fair Exchange in French and German Law* (pts. 1 & 2), 11 TUL. L. REV. 345 (1937), 12 TUL. L. REV. 42 (1937), and is made more explicitly in Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 621-24 (1943).

503. Dawson, *supra* note 502, pt. 1 at 345 n.*.

504. See John P. Dawson, *Effects of Inflation on Private Contracts: Germany, 1914-1924*, 33 MICH. L. REV. 171 (1934); John P. Dawson, *The Gold Clause Decisions*, 33 MICH. L. REV. 647 (1935); John P. Dawson & Frank E. Cooper, *The Effect of Inflation on Private Contracts: United States, 1861-1879* (pts. 1 & 2), 33 MICH. L. REV. 706, 852 (1935). On Dawson's life and work, see James J. White & David A. Peters, *A Footnote for Jack Dawson*, 100 MICH. L. REV. 1954 (2002).

505. Dawson, *supra* note 502, pt. 1 at 346.

frequently than did American ones. In France and Germany, as Dawson revealed, duress fit into a larger tradition of judicial price regulation, including the doctrines of usury and *laesio enormis* (whereby a judge could modify a sale if the price were half the “fair” value). These doctrines were used “to cancel out advantages secured through misuse of superior bargaining power.”⁵⁰⁶ Since the market, as Dawson put it, echoing Hale, was “merely another system, more elaborate and more highly organized, for the exercise of economic pressure,” the “central problem of modern times” was “the control of economic power.”⁵⁰⁷ As courts confronted this problem, the “connection between the concept of the fair exchange and the manifold problems produced by disparities in bargaining power” became ever “more intimate.”⁵⁰⁸ In their effort to address these “cognate problems of ensuring a fair exchange and redressing inequality of bargaining power,” German courts in World War I had, significantly, declared that “the pursuit of excessive profit in war time was an ‘exploitation’ of national necessities, forbidden by general rules of private law.”⁵⁰⁹

Economic Duress and the Fair Exchange received only a minor, oblique citation in the brief (it was the only law review article cited in the whole document).⁵¹⁰ Yet Dawson’s innovative understanding of duress pervades the argument, from the introduction focusing on “inordinate profits” to the exclusion of any reference to free will. Not tied down to the subjective state of the weak party, this approach to duress gave a court more leeway to recognize a dysfunctional market situation and to regulate prices within it openly.

This principle was evident in the Justice Department’s unconventional choice of precedent to support its argument. Had they wished, the attorneys easily could have cited the recent flowering of economic duress in courts across the country and encouraged the Supreme Court to follow the trend. The *American Law Reports* in 1932 noted that “business compulsion” was “tending more and more toward recognition.”⁵¹¹ A *Harvard Law Review* note in 1934 spoke of a “broader view of duress” taking hold in the courts.⁵¹² Williston in 1937 for the first time used the heading “economic duress” in his treatise and added

506. *Id.* pt. 2 at 73.

507. *Id.* pt. 1 at 345.

508. *Id.* pt. 2 at 73.

509. *Id.* pt. 2 at 68–69.

510. Govt. S. Ct. Br., *supra* note 220, at 67–68 (citing Dawson for the proposition that the civil law frequently recognizes duress in cases of purely economic compulsion; conceding that Anglo-American courts usually do not; but arguing that such courts do find duress in cases of “necessities created by grave emergency”).

511. Annotation, *Doctrine of “Business Compulsion,” supra* note 474, at 655.

512. Note, *Quasi-Contractual Recovery of Money Paid to Avoid Penalty or Forfeiture*, 47 HARV. L. REV. 1413, 1414 (1934).

several dozen supporting cases.⁵¹³

But the Justice Department largely ignored the recent case law. Instead, it focused on a separate line of precedent, one fully developed more than a century earlier: salvage cases in admiralty.⁵¹⁴ In the typical salvage case, a ship at sea ran into distress, and another ship, sailing by, rescued the crew and as much of the cargo as possible. When the sailors got back to shore, a court decided what compensation the rescued ship should pay the salvor. Rather than rely on the court to set the compensation, the two captains might, by contract, determine the price between themselves at sea. Such contracts, however, were made in a field where judges were accustomed to decide prices themselves. The admiralty courts thus reserved a "clear right" to ignore such agreements whenever the salvor was "taking advantage of his control of the situation."⁵¹⁵

The Justice Department invoked several salvage cases,⁵¹⁶ highlighting *Post v. Jones* (1856), in which the Supreme Court refused to approve an exorbitant bargain struck on a desolate shore. "The contrivance of an auction sale, under such circumstances," the *Post* Court declared, "where the master of the [distressed vessel] was hopeless, helpless, and passive—where there was no market, no money, no competition—where one party had absolute power, and the other no choice but submission . . . is a transaction which has no characteristic of a valid contract."⁵¹⁷ Where there was "no market" and "no competition," judges in admiralty had broad discretion to set prices, keeping in mind the value of the property, the labor expended, the level of risk, the quality of service, and the policy goal of encouraging future salvage.⁵¹⁸ In setting prices, judges had to consider how best to shape incentives, for salvage efforts "greatly protected" the "general interests of the navigation and commerce of the country."⁵¹⁹

The law of salvage was a world unto itself. In an ordinary case of

513. Compare WILLISTON & THOMPSON, *supra* note 496, § 1618, with SAMUEL WILLISTON, *THE LAW OF CONTRACTS* §§ 1617–1618 (1920).

514. See G.H. Robinson, *The Admiralty Law of Salvage*, 23 CORNELL L. REV. 229, 230 (1938) (stating that the salvage doctrine reached its contemporary form by the early 1800s).

515. *Id.* at 248. The first quotation is from *Magnolia Petroleum Co. v. National Oil Transport Co.*, 281 F. 336, 340 (S.D. Tex. 1922).

516. They were by far the most frequently cited type of case, both in the section on common law duress, Govt. S. Ct. Br., *supra* note 220, at 68–69, and in the section on unconscionability (which was based on quasi-duress), *id.* at 80–81.

517. *Post v. Jones*, 60 U.S. (19 How.) 150, 159 (1856), *quoted in* Govt. S. Ct. Br., *supra* note 220, at 68–69.

518. For these factors, see Robinson, *supra* note 514, at 230, 249–51. On the necessity for broad judicial discretion in salvage cases, see *The Emolous*, 8 F. Cas. 704, 707 (C.C. Mass. 1832) (Story, J.). The Justice Department quoted a discussion of the multiple policies behind salvage price determination. Govt. S. Ct. Br., *supra* note 220, at 81–82.

519. *Emolous*, 8 F. Cas. at 707 (quoting *The William Beckford*, 3 C. Rob. Adm. 355).

unconscionability or duress, the court merely imposed a fair market price—a price set collectively by numerous anonymous buyers and sellers, which the court simply observed and followed, without questioning its underlying justice or policy implications.⁵²⁰ In salvage, by contrast, where no working market existed, judges had power to consciously and deliberately impose their own conceptions of justice and efficiency. Conceptually, the task resembled that of officials under the Renegotiation Act, whose mission was to devise efficient incentives and enforce a publicly acceptable notion of distributive justice at a time when ordinary market processes did not meet the needs of the community.

The Justice Department was implicitly asking wartime judges to act like admiralty judges. Its claim, after all, depended on its assertion that Bethlehem neither achieved the cost reductions nor assumed the level of risk necessary to justify such a large profit.⁵²¹ Rather, Bethlehem deserved the usual compensation under a plain CPFF agreement. The Justice Department reassuringly stated that profit under a plain CPFF agreement had “been fixed by the practice of the market place” at about ten percent in wartime shipbuilding, meaning that judges were “not required to substitute their own judgment for that of the business community.”⁵²² Despite this reassurance, however, the Justice Department was still implicitly calling upon the Court to assume an activist regulatory role in the sense that the judges had to decide whether the plain CPFF agreement was the proper measure in the first place—a question that could not be answered without inquiring into incentives and risk.⁵²³ That is, the court still had to make the kind of inquiry typical of admiralty judges (and of officials under the Renegotiation Act). It was a difficult inquiry, to which courts typically were not suited. However, given that the Justice Department was invoking the aid of the judiciary as a last resort due to the absence of legislation, its attorneys did manage to find, in the law of salvage, the best judicial model available.

Before *Bethlehem*, nobody realized that salvage could provide this type of model. Up to 1941, no reported federal case had ever cited *Post v. Jones* outside of admiralty.⁵²⁴ (The only state cases to cite it concerned the compensation of fiduciaries—another area of strong judicial price regulation.⁵²⁵) In its focus on admiralty, the Justice Department may again have drawn inspiration from Dawson, who reported in his article

520. Hale, *supra* note 502, at 625.

521. See *supra* text accompanying notes 389, 391.

522. Govt. S. Ct. Br., *supra* note 220, at 74–75.

523. See *supra* text accompanying notes 389–394.

524. This is based on a search of the Westlaw database “Federal & State Case Law – Before 1945” for “*Post v. Jones*” or “19 How. 150” or “60 U.S. 150” or “60 U.S. (19 How.) 150,” for the years 1855 through 1942.

525. *Parker v. Hill*, 69 N.E. 336, 337 (Mass. 1904); *May v. May*, 109 Mass. 252, 258 (1872).

that courts in France had used salvage as the foundation for a much broader doctrine of economic duress.⁵²⁶

Jackson personally embraced the price-based concept of duress argued in the brief. His handwritten notes for oral argument make this clear. In the section on the law, the very first words under "Point I" are "Unequal bargaining power leaving no real choice in one require reasonable contract."⁵²⁷ Considering that Jackson was not close to the academy, it may be that other attorneys made the initial connection to Dawson's work. Once the approach was presented, though, we can see how Jackson's beliefs about the market made him receptive to it.

When discussing the bare procedures of the market, Jackson spoke in terms of pressure rather than voluntary action, of regulation rather than freedom. "Under [the] classical and competitive economic system," he wrote in 1937, "prices and production are regulated by competition."⁵²⁸ The point of trust-busting, as he put it, was "to avoid government regulation by letting business men *regulate each other* through the processes of competition."⁵²⁹ Big business might denigrate the price-cutting small firm as a "chiseler," but the "Antitrust Law philosophy relies on the chiseler to regulate."⁵³⁰

The virtues of the market, in Jackson's eyes, did not depend on the categorical definition of market actions as free or voluntary, but rather on the diffusion of actual decision-making power among a large number of individuals. This is what he meant when he used terms like "free economy."⁵³¹ Jackson's positive vision can be gleaned from his critique of corporate capitalism. "Big business," he feared, had "come to exercise an increasing power over the standard of living, the wages and the economic opportunities of our people."⁵³² Because of this, Jackson denounced big business as "The Menace to Free Enterprise."⁵³³ The expansion of corporate bureaucracy meant that fewer individuals had the chance to make real business decisions and share a measure of responsibility. "[I]n modern business," he lamented, there were "the many men 'who must do what they are told' and the few men who use the business machine as a

526. Dawson, *supra* note 502, at 353-55. The Justice Department may also have gotten the idea from the citation of *Post* in WILLISTON & THOMPSON, *supra* note 496, § 1608 n.3. Section 1608 is cited in Govt. S. Ct. Br., *supra* note 220, at 68.

527. Jackson, *supra* note 385, at 8.

528. Jackson & Dumbauld, *supra* note 404, at 237. Hale likewise spoke of prices as regulatory devices. Hale, *supra* note 486, at 168.

529. Letter from Robert H. Jackson, Assistant Attorney General, to Bruce Barton (July 15, 1937) (General Correspondence, Box 9, RHJ-LC, *supra* note 22).

530. *Id.*

531. For the term "free economy," see Jackson, *supra* note 257, at 830.

532. Jackson, *supra* note 418, at 3.

533. *Id.* at 1.

whole 'with imperial freedom of design.'"⁵³⁴ Freedom for the few, in other words, meant restriction for the many.

The rise of big business, then, had constricted the freedom of individuals by transferring opportunities away from proprietorships and toward bureaucratic positions. These bureaucracies, in turn, made it possible for corporations to grow big enough to acquire market power, which in turn constricted the freedom of buyers. In the economic slump of 1937, Jackson accused big business of raising the prices of commercial goods above their 1929 levels. These were "prices only big business could get"—that only market power could sustain—and that "small business and consumers were forced to pay."⁵³⁵ In reaction to incidents like this, Americans wanted "freedom from arbitrary economic power."⁵³⁶ The chief example of that arbitrary power was unilateral price-setting. Lumping monopoly behavior together with socialist planning, Jackson insisted that the "American people desires no economic or political dictatorship imposed either by government or by big business, no system of detailed price regulation by governmental edict or of price fixing by decree of private interests."⁵³⁷ In this context, it makes sense that Jackson wanted to rein in the large war contractor, who, in the words of the brief, "has an unqualified power to exact such terms as he chooses."⁵³⁸ For Jackson, the unlimited exercise of economic power, manifested in unreasonable prices, violated the only notions of freedom and coercion that made any sense to him.

Jackson's economic philosophy illuminates not only the argument he presented, but also the reason he cared so much about the appeal in the first place. With the war administration strapped for managers, it saved time and money by dealing mainly with the biggest firms. Of the prime contracts awarded in the latter half of 1940, sixty percent went to only twenty firms, and eighty-seven percent went to only one hundred firms.⁵³⁹ As Jackson once wrote, "No condition is so favorable to corporate growth as profits," for they "both provide and attract capital."⁵⁴⁰ Large profits on defense contracts, then, were tied in the most direct way to the growth of the largest firms, the institutions Jackson most feared. Further, since World War II necessitated the first broad-based income tax,⁵⁴¹ those profits would come in large part from the pockets of ordinary Americans, the people Jackson most wanted to protect from corporate dominance.

534. Jackson, *supra* note 421, at 3. Jackson is quoting Woodrow Wilson without citation.

535. *Id.* at 5.

536. *Id.* at 3.

537. Jackson & Dumbauld, *supra* note 404, at 237.

538. Govt. S. Ct. Br., *supra* note 220, at 67.

539. WADDELL, *supra* note 31, at 78–79.

540. Robert H. Jackson, *The Big Corporations Rule*, NEW REPUBLIC, Sept. 4, 1935, at 99.

541. KENNEDY, *supra* note 62, at 624–25.

Jackson's view of the market originated from the small-farmer tradition in which he grew up.⁵⁴² That tradition was an offshoot of the philosophy of republicanism, which scholars of the eighteenth and nineteenth centuries have increasingly recognized as a long-standing American alternative to liberalism.⁵⁴³ In the republican view, the main goal of politics was to fend off authoritarian rule—something that could only be accomplished if individual citizens each possessed enough independent wealth and security to make political judgments in a disinterested fashion. Jackson picked up on this theme when he said that small businessmen were more trustworthy and principled defenders of free enterprise than corporate employees could ever be.⁵⁴⁴ From this perspective, the distribution of ownership rights and economic power had far-reaching public consequences. This undermined liberalism's public/private distinction and the categorical, non-substantive notions of freedom and coercion that went with it, including the free-will definition of duress. When discussing the nature of freedom, twentieth-century republicans like Jackson—and the Southern and Western populist Congressmen who provided most of the votes for the New Deal—spoke a language similar to that of liberal intellectuals like Hale and Dawson, even though these intellectuals derived their notions of freedom from totally separate sources, such as Marxian socialism and Jamesian pragmatism.⁵⁴⁵ Republicans like Jackson and left-liberals like Hale disagreed on many things (e.g., the latter were more sanguine about the fairness and efficiency of public bureaucracy).⁵⁴⁶ Yet they were united in their aversion to corporate power and in their intuitive understanding of freedom, both of which were crucial to the *Bethlehem* appeal.

E. THE STRUGGLE OVER THE MEANING OF JUDICIAL RESTRAINT

Had the Court accepted the Justice Department's theory, it would have been a major transfer of responsibility to the judiciary. This went against the tide of the New Deal and of early twentieth-century progressivism as a whole. Generally, in the eyes of progressives, courts

542. BRINKLEY, *supra* note 16, at 60.

543. The extensive literature on republicanism includes ERIC FONER, *FREE SOIL, FREE LABOR, FREE MEN: THE IDEOLOGY OF THE REPUBLICAN PARTY BEFORE THE CIVIL WAR* (1970); STEVEN HAHN, *THE ROOTS OF SOUTHERN POPULISM: YEOMAN FARMERS AND THE TRANSFORMATION OF THE GEORGIA UP-COUNTRY, 1850-1890* (1983); SEAN WILENTZ, *CHANTS DEMOCRATIC: NEW YORK CITY AND THE RISE OF THE AMERICAN WORKING CLASS, 1788-1850* (1984); GORDON S. WOOD, *THE RADICALISM OF THE AMERICAN REVOLUTION* (1993); William E. Forbath, *The Ambiguities of Free Labor: Labor and Law in the Gilded Age*, 1985 Wis. L. Rev. 767.

544. Letter from Robert H. Jackson to Bruce Barton, *supra* note 529.

545. On Hale's intellectual origins, see FRIED, *supra* note 1, at 18-19. For a general treatment of the intellectual background to twentieth-century liberalism, see JAMES T. KLOPPENBERG, *UNCERTAIN VICTORY: SOCIAL DEMOCRACY AND PROGRESSIVISM IN EUROPEAN AND AMERICAN THOUGHT, 1870-1920* (1986).

546. Hale supported the systematic collectivization of rents. FRIED, *supra* note 1, at 148.

lacked the capacity to address economic problems, which were best left to legislatures and executive officials. Though less enthusiastic about executive planning than most of his colleagues, Jackson generally shared their skepticism of judicial power. The legislature and executive had to act affirmatively to prevent or roll back the concentration of private power that Jackson so much despised. Antitrust policy, he hoped, would rescue the competitive system and stave off the imposition of public economic planning that unchecked private power would otherwise necessitate.⁵⁴⁷ But the federal courts, much to Jackson's disappointment, had willfully misconstrued and "perverted" his beloved antitrust laws.⁵⁴⁸ Judges' penchant for "evading or emasculating laws they don't like" caused the problems targeted by those laws to fester, demanding more drastic remedies in the future. The disastrous NRA might never have seemed necessary if the courts had not substituted their own judgment for that of the legislature from the 1890s to the 1930s.⁵⁴⁹

Even if judges were not recalcitrant, worried Jackson, the threat of monopoly was so large and protean that it strained the institutional capacity of the courts, which were restricted to deciding narrow cases with particularized facts, making it hard for them to tackle the crisis as a whole.⁵⁵⁰ And when the legislature tried to place checks on concentrated economic power, the very process of litigation proved so slow and expensive that private interests could use it as an instrument to thwart those checks. Despite his reservations about administrative agencies, Jackson as Attorney General denounced a proposal to saddle them with highly intrusive judicial review, since this would place new "weapons in the hands of those whose animus is strong enough and whose purse is long enough to wage unrestricted warfare on the administration of the laws."⁵⁵¹ The judiciary was a machine set in motion by private parties, and so long as such parties wielded disproportionate power, courts could not be fully trusted.

Frankfurter was the only voting member of the Court to accept the

547. Jackson & Dumbauld, *supra* note 404, at 237-38.

548. *Id.* at 243.

549. Robert H. Jackson, *It's Up to Us*, COMMENTATOR, Dec. 1937, at 43, 47. Also, Jackson supported Roosevelt's court-packing plan, deemphasizing the President's disingenuous justification for it as an effort at administrative efficiency, and arguing (more honestly) that it was necessary to bring "the elective and non-elective branches of the Government back into a proper coordination." Stephen R. Alton, *Loyal Lieutenant, Able Advocate: The Role of Robert H. Jackson in Franklin D. Roosevelt's Battle with the Supreme Court*, 5 WM. & MARY BILL RTS. J. 527, 571 (1997).

550. Jackson & Dumbauld, *supra* note 404, at 255-56 (stating that the adversary process and case-by-case decisions are not adequate to deal with monopoly); see also Jackson, *supra* note 549, at 45 (noting that judicial policies are revealed piecemeal); ROBERT H. JACKSON, *THE STRUGGLE FOR JUDICIAL SUPREMACY* 286-302 (reprint 1979) (1941) (giving a full critique of "government by lawsuit").

551. Robert H. Jackson, *Untitled report of the Attorney General recommending veto of the Walter-Logan Bill*, Dec. 11, 1940, in 86 CONG. REC. 13,943, 13,944 (1940). On Jackson's reservations about agencies, see *id.* at 13,945.

duress theory. His support for it was even more anomalous than Jackson's. Frankfurter was less nostalgic than Jackson for the atomistic economy of the nineteenth century and more optimistic about the potential of expert public administration.⁵⁵² Accordingly, his doubts about the judiciary were even greater than Jackson's. On the Court, Frankfurter gained a reputation for unmatched deference to the political branches.⁵⁵³ This attitude derived from his beliefs about the relative competence of different governing institutions. In constitutional interpretation, for example, Frankfurter drew a distinction between relatively specific rules and general standards like the due process clause. Courts could legitimately apply the former, but with respect to the latter, "application is largely unrestricted and the room for play of individual judgment as to policy is correspondingly wide."⁵⁵⁴ That opened the way for abuse.⁵⁵⁵ When judges indulged the "illusion of mathematical certainty," they were too often "translating their own unconscious economic prejudices or assumptions."⁵⁵⁶ Judges had no right to do that, argued Frankfurter, for they were not as well-positioned as other institutions to deal with modern economic problems. Those problems, complex and unprecedented, could be addressed only through aggressive experimentation in policy, which a legislature could do far better than a passive court. Fruitful experimentation required information to be gathered across society, and legislatures and agencies were better at that, too.⁵⁵⁷

Nowhere were the limits of abstract categorical principles more apparent than when judges took up the task of setting prices. Progressives of every stripe, Frankfurter included, had long bemoaned the federal courts' practice of requiring regulatory commissions to allow public utilities a "fair return" on the "fair value" of their property. The "fair return" requirement, argued liberal economists, was simply meaningless: the expected return on a business asset determined its value, so it was impossible to use the value as the basis for setting the return.⁵⁵⁸ In reality, thought liberals, utility rates depended on a subjective political choice about distributive justice between producers and consumers, as well as technical determinations about the optimal

552. For Frankfurter on public administration, see FELIX FRANKFURTER, *THE PUBLIC AND ITS GOVERNMENT* 151-64 (1930).

553. For an overview of commentary on Frankfurter's deference, see Alfred S. Neely, *Justice Frankfurter, Universal Camera and a Jurisprudence of Judicial Review of Administrative Action*, 25 U. TOL. L. REV. 1, 1-6 (1994); see also JEFFREY D. HOCKETT, *NEW DEAL JUSTICE: THE CONSTITUTIONAL JURISPRUDENCE OF HUGO L. BLACK, FELIX FRANKFURTER, AND ROBERT H. JACKSON* 141-213 (1996).

554. MICHAEL E. PARRISH, *FELIX FRANKFURTER AND HIS TIMES: THE REFORM YEARS 167-68* (1982).

555. *Id.* at 168.

556. *Id.* at 75.

557. FRANKFURTER, *supra* note 552, at 48-51.

558. For Hale's critique of "fair return," see FRIED, *supra* note 1, at 176-78.

level of investment and the rate needed to attract it. Frankfurter expressed this thinking in 1939: "The determination of utility rates—what may fairly be exacted from the public and what is adequate to enlist enterprise—does not present questions of an essentially legal nature in the sense that legal education and lawyers' learning afford peculiar competence for their adjustment." The matter should be left to "commissions and legislatures."⁵⁵⁹

This progressive critique applied to numerous instances of judicial interference with legislative and administrative policies about resource allocation, from rate regulation to industrial organization to labor relations. Surprisingly, Jackson and Frankfurter did not follow this critique—indeed, vehemently rejected it—with respect to the pricing of defense contracts. But surely this was an area suited to legislative and administrative competence. The Constitution gave Congress the power to maintain the military. It made the President commander-in-chief. Contract pricing was an integral part of mobilization, the most complicated economic task a modern government could undertake. It implicated numerous matters of policy: meeting military needs, insuring against risk, allocating new investment, encouraging efficiency, and so forth. Indeed, at the same time the Justice Department was preparing the *Bethlehem* brief, Jackson was telling the President to veto an administrative procedure bill that would have, among other things, mandated judicial review of defense-related agencies' contracting decisions. The "awarding of contracts," thought Jackson, fell into the category of "actions of an executive or administrative nature" that had "never been regarded as . . . reviewable" by courts. Under the new proposal, however, the discretion necessary to the executive would be "transferred to the courts." Hence, the bill threatened "to retard and hamper the work of the executive branch."⁵⁶⁰ It is hard to ignore the force of this point. In hindsight, the staggering workload borne from 1942 to 1945 by the large renegotiation agencies (which did not even need to reckon with judicial procedures) cast doubt on whether the courts could have managed the task of keeping contract prices in line.⁵⁶¹

Not only did defense contracting strain the technical competence of courts, it was also unavoidably and obviously political. If utility rate

559. *Driscoll v. Edison Light & Power Co.*, 307 U.S. 104, 122 (1939) (Frankfurter, J., concurring). Senator Champ Clark, in the midst of interrogating Bethlehem's president about the justice of war profits, attested that the controversy over "the fair return on utility investments" was "a comparable situation to a cost-plus contract" in wartime, due to the difficulty of deciding what costs to allow. *Nye Hearings*, *supra* note 143, at 5739.

560. Jackson, Untitled report of the Attorney General recommending veto of the Walter-Logan Bill, *supra* note 551, at 13,945.

561. SMITH, *supra* note 25, at 358–67 (on the decidedly non-judicial organization and operations of the renegotiation bureaucracy), 384 (stating that the "size of the total case load" made "satisfactory performance impossible"), 388–91 (on the size of the task).

regulation entailed the question of just distribution between producers and the public, defense contracting entailed that same question at even higher intensity. From the beginning, the procurement program consisted of a delicate political dance between Roosevelt and big business. The President had to induce corporate leaders to accept his politically tenuous internationalist agenda.⁵⁶² This helps explain his acquiescence to the Second Revenue Act. It helps explain why he did "not find it politic to bring the [war profits] tax question directly to the nation."⁵⁶³ The political branches were meant to handle this balancing of competing social interests.

Bethlehem's lawyers realized the awkwardness of the New Dealers' request for judicial intervention. The Justice Department, so they argued, was "asking this Court to appropriate to the judicial branch . . . a function which is legislative and executive in its essential character."⁵⁶⁴ It was asking the Court to overturn the Congressional choice to implement profit-friendly policies in the Second Revenue Act. There was a delicious irony here. Since the nineteenth century, corporations like Bethlehem had urged courts to limit the regulatory discretion of legislatures. Bethlehem's lead attorney, Frederick H. Wood, achieved just such a result in *Schechter Poultry*, in which the Court struck down the centerpiece legislation of the New Deal.⁵⁶⁵ Now that the Justice Department was urging the courts to control contract prices more aggressively than Congress had, big business was crying judicial usurpation.

Still, irony aside, Bethlehem had a point. Walter B. Kennedy, a professor at Fordham Law School and a genuine adherent to the Holmesian tradition of judicial restraint,⁵⁶⁶ predicted that the *Bethlehem* case would prove a "crossroads decision," on a par with *McCulloch* and *Lochner*, for it tested whether the New Deal Justices would hold themselves to the principle that "Governmental 'policies' should not be reviewed by judicial bodies."⁵⁶⁷ The "wisdom or expediency of attempts to fix profits, prices and wages," Kennedy insisted, "should reside in the

562. BRANDES, *supra* note 26, at 245-47; CATTON, *supra* note 98, at 16-17.

563. Gissen, *supra* note 435, at 755-56.

564. Brief for Respondents at 77, 83, *United States v. Bethlehem Steel Corp.*, 315 U.S. 289 (1942) (Nos. 8 & 9). Although Bethlehem's general point rang true, its particular accusation that the Justice Department was trying to re-impose flat-rate profit limitation was not quite accurate since the Department was in fact advocating a more flexible approach, in which, for example, increased efficiency could justify increased profit. See *supra* text accompanying notes 389-391.

565. *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 500 (1935) (giving Wood's name).

566. Kennedy, *supra* note 23, at 140 (stating that the "morals of the market place" should be corrected "not by an unwise extension of the judicial power, but by 'the enactment of a statute in accordance with established forms'").

567. *Id.* at 139.

Congress and/or in the President," since these branches, unlike courts, were capable of "flexible and changing discretion."⁵⁶⁸

How, in light of their commitment to judicial restraint, could Jackson and Frankfurter support the duress theory? For one thing, a federal judge would have the opportunity to re-price a contract if and only if the executive initiated the process by invoking duress in court. The theory entailed not independent judicial power, but judicial power on the condition of executive authorization. In light of this, one might question the benefits of the strategy to the opponents of big business, since the wartime executive drew heavily from the business world. However, the executive branch contained not only career businessmen, but also career military officers. While those officers after 1945 became identified with the "military-industrial complex," their allegiance in 1940 was uncertain, especially considering the long-standing tradition of independent military professionalism.⁵⁶⁹ Besides, even if a military-corporate alliance ran the administration during the war, litigation might continue after it ended, by which time more disinterested personnel might be in charge and (more importantly) the pressure of the emergency would have lifted. As we have seen, Jackson feared the judicial machinery in part because concentrated private power had the ability to set it in motion; that was not a concern here.

Under this explanation, the *Bethlehem* appeal might seem an effort to carve a route through the judiciary by which the executive could circumvent the generous profit policies of Congress. In purely cynical terms, this might not have been a bad strategy for liberals. Ever since 1938, Congress had been growing less sympathetic to Roosevelt and more friendly to big business. Meanwhile, from 1933 to 1941 the proportion of Democratic appointees on the U.S. Court of Appeals rose from about twenty percent to over seventy percent.⁵⁷⁰ Further, since about 1935 the Justice Department had been vetting nominees to ensure they were friendly to administration policy.⁵⁷¹

Still, Jackson and Frankfurter could not have justified, to others or to themselves, a deliberate attempt to subvert the people's intent as expressed in Congress. But to Jackson, war created a bargaining situation that cast doubt on the legitimacy of public decisions. In World War I, as

⁵⁶⁸ *Id.* at 164.

⁵⁶⁹ Koistinen, *supra* note 56, at 104 (1982) (stating that the military had been suspicious of corporate America before 1940); WADDELL, *supra* note 31, at 51 (stating that the military services were relatively autonomous at the start of World War II).

⁵⁷⁰ DONALD R. SONGER ET AL., CONTINUITY AND CHANGE ON THE UNITED STATES COURTS OF APPEALS 30, fig. 2.2 (2000).

⁵⁷¹ SHELDON GOLDMAN, PICKING FEDERAL JUDGES: LOWER COURT SELECTION FROM ROOSEVELT THROUGH REAGAN 30-38 (1997); see also Rayman L. Solomon, *The Politics of Appointment and the Federal Courts' Role in Regulating America: U.S. Courts of Appeals Judgeships from T.R. to F.D.R.*, 1984 AM. BAR FOUND. RES. J. 285, 323-27 (1984).

Jackson said in 1937, Congress and the executive adopted the policies they did only because "big business would not 'cooperate' on any other terms."⁵⁷² They were acting "under pressure of war."⁵⁷³ This claim—made in a political speech—was even more radical than the legal claim that Bethlehem coerced the EFC, for it suggested that the political branches themselves might be deprived of the capacity to act in the public interest. Indeed, some liberal criticism just before and after passage of the Second Revenue Act reflected not just disagreement but de-legitimation. The legislation was "lobby-written," exacted through a "hold up" or a "Sit-Down [strike]."⁵⁷⁴ As we have seen, Jackson's embrace of judicial restraint was pragmatic to begin with, a response to judges' failure to fulfill his overriding substantive goal of controlling concentrated power.⁵⁷⁵ By 1940, courts had become less threatening and the defense establishment more so, so it makes sense that Jackson wanted to use all available means to protect his concept of the public interest. As a remedy for Bethlehem's abuse, he would have preferred strong legislation if he could get it,⁵⁷⁶ but if he could not, the courts were a fallback.

Besides, the Justice Department technically did not defy Congress because judicial price-setting rested on the common law, not the Constitution. This distinguished it from a utility's request for a judicial price increase, or the Schechters' request for judicial protection from the NRA. If a court altered the price of a defense contract on the ground of duress, it would only be enforcing a default rule, one that Congress could modify. However, Congress might find it politically difficult to override a Supreme Court decision that accused a big corporation of exploiting the nation's necessity for unconscionable gain.

Another reason for liberals to embrace the duress theory was that they generally considered common law creativity to be necessary and honorable, especially when it furthered some legislative impulse and, often, even when it did not.⁵⁷⁷ This factor is especially illuminating in Frankfurter's case. He shared the ascendant progressive view that the judiciary did and should make policy choices. Yet he emphasized, more than did many of his progressive colleagues, that the judge operated under a different set of institutional and professional constraints than did the legislator and could therefore be expected to be somewhat more

572. Jackson, *supra* note 421, at 3.

573. *Id.*

574. See *supra* text accompanying notes 427-430, 440-443.

575. See GLENDON SCHUBERT, *DISPASSIONATE JUSTICE: A SYNTHESIS OF THE JUDICIAL OPINIONS OF ROBERT H. JACKSON* 315-29 (1969) (explaining how Jackson, as a Justice, pragmatically weaved between different attitudes on the relations of judicial power to bureaucratic power and individual rights).

576. Letter from Jackson to Lindley, *supra* note 364 (stating, with respect to the District Court's ruling in the *Bethlehem* case: "This is the sort of thing that creates the necessity for some legislation.").

577. See *supra* text accompanying notes 12-16.

principled.⁵⁷⁸ In keeping with this emphasis on constraints, Frankfurter had more respect than did many of his allies for the half-conscious manner in which judges typically made common law. Consider a passage from Holmes that Frankfurter admired. According to the “official theory,” as Holmes put it, each common law decision followed “syllogistically from existing precedents.”⁵⁷⁹ Yet “in substance,” the growth of the common law was “legislative.”⁵⁸⁰ The “secret root from which the law draws all the juices of life” was the judge’s unspoken consideration “of what is expedient for the community.”⁵⁸¹ Hence, “when ancient rules maintain themselves . . . , new reasons more fitted to the time have been found for them, and . . . they gradually receive a new content and at last a new form from the grounds to which they have been transplanted.”⁵⁸² Later on, Frankfurter himself expressed the more general principle that courts can and should make policy decisions, but only when confined by preexisting conceptual bounds. Judges “cannot decide things by invoking a new major premise out of whole cloth.”⁵⁸³ They had to “make the law that they do make out of the existing materials and with due deference to the presuppositions of the legal system of which they have been made a part.”⁵⁸⁴

The private law of contracts, Frankfurter believed, was shot through with historically grounded checks on the use of bargaining power. “The fundamental principle of law that the courts will not enforce a bargain where one party has unconscionably taken advantage of the necessities and distress of the other,” he insisted, “has found expression in an almost infinite variety of cases.”⁵⁸⁵ As this phrasing suggests, Frankfurter largely followed the Justice Department’s definition of duress as a necessitous and unfair exchange, lapsing into the language of free will very rarely in his twenty-five-page dissent.⁵⁸⁶ Yet whereas the Justice Department had

578. Felix Frankfurter, *Some Reflections on the Reading of Statutes*, 47 COLUM. L. REV. 527, 533–35 (1947) (noting both the judge’s duty, in the realm of common law, of “adaptation and adjustment of old principles to new conditions” and the difference between judge and legislator). On the emergence of an entire “legal process” school based in part on Frankfurter’s thinking, see DUXBURY, *supra* note 2, at 223–41; Grey, *Modern American Legal Thought*, *supra* note 2, at 502–05.

579. FELIX FRANKFURTER, *The Early Writings of O.W. Holmes, Jr.*, in FELIX FRANKFURTER ON THE SUPREME COURT: EXTRAJUDICIAL ESSAYS ON THE COURT AND THE CONSTITUTION 234, 237 (Philip B. Kurland ed., 1970).

580. *Id.* at 236.

581. *Id.*

582. *Id.* at 237.

583. Melvin I. Urofsky, *Conflict Among the Brethren: Felix Frankfurter, William O. Douglas and the Clash of Personalities and Philosophies on the United States Supreme Court*, 1988 DUKE L.J. 71, 77 (citation omitted).

584. *Id.* (citation omitted).

585. *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 327–28 (1942) (Frankfurter, J., dissenting).

586. *Id.* at 322–24 (analyzing the fairness of the exchange), 336 (stating that the “pressures of war deprive [contracting officers] of equality of bargaining power in situations where bargaining with

selected precedents somewhat narrowly, zeroing in on the salvage cases, Frankfurter cited seemingly any case he could find that invalidated a contract for necessitous unfair exchange, the more ancient the better.⁵⁸⁷ He seemed more concerned with proving the antiquity and familiarity of the broad doctrine than with finding cases that bore an analytic similarity to the present policy problem. As we shall see below, Frankfurter grasped the policy problem exceptionally well, so his broad citation strategy can probably be explained as a reflection of his particular version of common law creativity, which rested for its legitimacy on finding a sturdy historical principle to apply in new situations. The duress doctrine's supposed familiarity and antiquity also suggested that Congress might have known about the doctrine and relied upon its existence, adding the legitimating glow of legislative approval to an already ancient principle. By authorizing the executive to make contracts without special legislative protections, Frankfurter insisted, "Congress did not impliedly repeal historic legal principles."⁵⁸⁸ "Authority . . . to make contracts," by this reading, did "not imply authority to make unconscionable contracts."⁵⁸⁹ Indeed, congressional floor debates from World War I, he noted, showed that "Congress expected that the shipbuilders of the nation would provide their services for a reasonable compensation."⁵⁹⁰

To the majority, however, Frankfurter's stance was judicial activism. Writing for the Court, Black wrote that "if the Executive is in need of additional laws by which to protect the nation against war profiteering, the Constitution has given to Congress, not to this Court, the power to make them."⁵⁹¹ One might think that Black, a New Dealer and onetime Senator, was simply following the normal path of judicial quietism,

private contractors is the only practicable means of securing necessary war supplies"). Frankfurter never used the words *will*, *agency*, *consent*, *voluntary*, *involuntary*, *volition*, *overcome*, or *deprive* in the sense that they were used in the "free will" analysis. He quoted Holmes' well-known statement that the party under duress is still making a choice. *Id.* at 326-27 (quoting *Union Pac. R.R. Co. v. Pub. Serv. Comm'n*, 248 U.S. 67, 70 (1918)). (The same Holmes quotation appears in *Hale*, *supra* note 486, at 150.) Frankfurter did occasionally come near to indulging in the old free-will language, as when he said it was "a basic psychological truth" that "[w]here the one person can dictate, and the other has no alternative but to submit, it is coercion." *Bethlehem*, 315 U.S. at 327 (quoting *Atkinson v. Denby*, 7 Hurlst. & N. 934, 936). He also quoted the aphorism that "necessitous men are not . . . free men." *Id.* at 326 (quoting *Vernon v. Bethell*, 2 Eden 110, 113).

587. As to the sheer volume and factual variety of cases cited, compare *Govt. S. Ct. Br.*, *supra* note 220, at 63-85, with *Bethlehem*, 315 U.S. at 325-30 (Frankfurter, J., dissenting). Frankfurter explicitly emphasized the antiquity of the doctrine. *Id.* at 313, 327, 329; see also Letter from Frankfurter to the "Brethren" (Jan. 6, 1942) *microformed on* The Felix Frankfurter Papers, *supra* note 219, at Part I, Reel 4 (stating that, in writing his dissent, "much material has to be plowed through that apparently was not covered by the briefs").

588. *Bethlehem*, 315 U.S. at 335 (Frankfurter, J., dissenting).

589. *Id.* at 334.

590. *Id.*

591. *Id.* at 309.

letting the political branches find their own answers to a question that judges were not suited to address.

However, Black was not as passive as one might think. He was hardly one to suppress his own political opinions. During his ten years in the Senate, he had been "probably the most radical man" in the chamber,⁵⁹² a Southern populist crusading against everything from alcohol and immigration to public utility holding companies and the Supreme Court (he was perhaps the strongest backer of Roosevelt's court-packing plan).⁵⁹³ After the failure of that plan, Roosevelt thirsted for revenge. He decided to ruffle the feathers of his Senatorial opponents by putting the marginal Black on the Court. The appointment, as even a recent (and sympathetic) biographer of Black has written, was a "joke" that the President played "on all the politicians and pundits in Washington."⁵⁹⁴ Black did not disappoint. In his first years on the bench, he became notorious for his "intense political partisanship and mediocre legal abilities," exhibiting "quixotic behavior" in trying to get non-progressive doctrines overturned overnight.⁵⁹⁵ Even Brandeis and Stone, liberals though they were, worried about Black. "There are enough presentday battles of importance to be won," wrote Stone, "without wasting our efforts to remake the Constitution *ab initio*, or using the judicial opinion as a political tract."⁵⁹⁶

The government contract system was Black's *bête noire*, as it was for many Southern populists. The system, from the populist perspective, allowed Northeastern monopolists to gain special privileges and grow fat at the expense of the public.⁵⁹⁷ Because it was so easy for corporations to exploit the public through the contract system, Black wanted to abolish it wherever possible and replace it with public enterprise. Starting in the 1920s, for instance, the government had subsidized the aviation industry through generous air mail contracts. In 1934, Black led an investigation and discovered that these plums were handed exclusively to the biggest airlines through "spoils conferences."⁵⁹⁸ He helped persuade Roosevelt to make the precipitous move of canceling all the contracts and having the Army deliver the mail. The Army had neither the know-how nor the equipment for the job, and the quick transition helped cause sixty-six accidents and twelve deaths during the three months of the ill-fated

592. ROGER K. NEWMAN, *HUGO BLACK: A BIOGRAPHY* 226 (1994) (quoting JOSEPH ALSOP & TURNER CATLEDGE, *THE 168 DAYS* (1938)).

593. On Black in the Senate, see *id.* at 125-230.

594. *Id.* at 237.

595. PARRISH, *supra* note 554, at 276.

596. *Id.* at 277 (citation omitted).

597. Josephus Daniels and Benjamin Tillman were Black's predecessors in this populist tradition. On their efforts with respect to armor-plate contracts, see COOLING, *supra* note 57, at 183-212; UROFSKY, *supra* note 28, at 117-51.

598. HAWLEY, *supra* note 401, at 240.

endeavor. The fiasco proved yet again how hard it was for the government to take up complex business operations on short notice. Undeterred, Black in 1935 became a leading opponent of Roosevelt's demand for merchant marine subsidies, advocating a government-operated fleet instead.⁵⁹⁹

The Justice Department appeal in *Bethlehem* was Black's chance to confront the hated contract system from the bench. Not surprisingly, he considered Bethlehem's conduct "outrageous" and voted for certiorari. As with so many issues, however, Black had his own peculiar ideas about how best to use the Court to accomplish a goal. Black wanted the Court to hear the *Bethlehem* appeal because, as he told Jackson, it would give him the chance to *uphold* the decisions below and "to write an opinion which would show that [Bethlehem's large profit] was simply the usual thing that happened under these contract systems."⁶⁰⁰ If a party contracts carelessly, a judge may enforce the resulting obligation, however harsh, in order to motivate parties to be more careful in the future. Black's strategy was to do the same thing to Congress: enforce the contract as a kind of punishment—a way to attract publicity and spur reform. "As much as I abhor the [contract] system," he told the other Justices in conference on December 20, 1941, ruling for Bethlehem was "the best way to stop it."⁶⁰¹ Black hoped "to knock out the contract system and have the government build its own ships,"⁶⁰² a position so extreme that no important political figure at that time seriously considered it.⁶⁰³

As in the air mail controversy, Black was naively optimistic about how effective agencies could be when they took over business operations on short notice. In his opinion, he spoke of the EFC and of Congress as if these institutions had the ability to seize or create industrial operations at will, but simply lacked the initiative. The EFC, noted Black, had statutory power to seize plants or to order them to produce at set prices, yet it "declined" to use these methods and instead "chose . . . to make purchases through ordinary business bargaining."⁶⁰⁴ The seizure power, he believed, "provided the Fleet Corporation with an alternative bargaining weapon difficult for any company to resist."⁶⁰⁵ Even if the agency were coerced, continued Black, Congress should have foreseen the coercive circumstances inherent in private wartime procurement and

599. *Id.* at 237.

600. Jackson, *supra* note 257, at 998–99.

601. Frank Murphy's Notes from Conference, *quoted in* NEWMAN, *supra* note 592, at 289. For the date of the conference, see Murphy's untitled notes from the conference (Dec. 20, 1941) (Supreme Court Case Files, 1941 Term, *United States v. Bethlehem Steel Corp.* (Nos. 8–9), p. 73, Roll 123, Frank Murphy Papers, Bentley Historical Library, Univ. of Michigan, Ann Arbor, MI).

602. Jackson, *supra* note 257, at 999.

603. Higgs, *supra* note 21, at 173.

604. *United States v. Bethlehem Steel Corp.*, 315 U.S. 289, 292 (1942).

605. *Id.* at 304.

steered clear of them. "When Congress authorized the procurement of ships through ordinary commercial negotiations," he insisted, "it must have known that the purchases could not be made in a market of open competition."⁶⁰⁶ The Court should not invalidate a contract because of the "coercive effect of circumstances which Congress clearly contemplated."⁶⁰⁷ If the Court did otherwise, it would violate Congress' intent.⁶⁰⁸

Because the duress theory was the product of Jackson's post-New Deal Justice Department, it had not been in anybody's mind when the two sides were taking testimony in the late 1920s and early 1930s. Therefore, as Black rightly pointed out, there was no direct evidence that Bethlehem's executives, if the government had seized the firm, would have refused to work in it.⁶⁰⁹ On top of that, Radford testified that it was not the "proper policy" of the EFC to dictate prices to contractors,⁶¹⁰ suggesting that perhaps the EFC lacked the will to exercise the seizure power even if it seemed feasible. Black scoffed at the EFC for discounting the seizure option before it had "even . . . suggested [it] to Bethlehem."⁶¹¹ Further, continued Black, even if the agency did threaten seizure and even if the Bethlehem executives refused to cooperate, the agency might still have attempted to seize the firm or give it a production order.⁶¹² Under Black's rationale, the government could invoke duress only if it tried to seize the firm and failed. It did not enter his mind that a reasonable administrator, faced with the doubtfulness of success and the dire consequences of failure, might conclude that it was too risky to try to seize the firm and that the option should simply be left off the table. The government, in Black's view, was obliged to play a game of chicken with the contractor. Once it got to the edge of the cliff and swerved, then it could invoke duress.⁶¹³

606. *Id.*

607. *Id.* at 305.

608. For Black's discussion of the separation-of-powers issue, see *id.* at 308.

609. *Id.* at 303.

610. Master's Report, *supra* note 174, at 536.

611. *Bethlehem*, 315 U.S. at 303.

612. *Id.*

613. One additional point should be noted regarding Black's treatment of the duress argument. He stated that "[t]wo basic propositions" underlay the government's duress claim: "(1) The Government's representatives involuntarily accepted Bethlehem's terms. (2) The circumstances permitted the Government no other alternative." *Id.* at 301. Black was misstating the government's claim. In fact, the government never relied on the first of the two propositions, i.e., that the officers acted "involuntarily," which proposition Black later said implied a "state of overcome will." *Id.* In reality, the Justice Department relied solely on the second proposition, i.e., that the "circumstances permitted . . . no other alternative." *Id.* On the Justice Department's argument, see *supra* text accompanying notes 467-473. Black refuted the first proposition with ease. *Bethlehem*, 315 U.S. at 301-03. This was easy, since the free-will theory was inherently incoherent. However, it seems that the second proposition, if proved, would have satisfied Black that duress existed. We can assume this in light of the fact that Black, after rejecting the first proposition, still addressed the second one, stating

Black's interpretation defied the unanimous fact-findings of the adjudicators below. The Third Circuit, the District Judge, and the Special Master each stated that attempting to seize the firm would have defeated the agency's purpose. Besides, the Nye Committee, which performed the most complete investigation of the problem, found that the government had no practical power to give orders to large firms.⁶¹⁴ Even Bethlehem's lawyers conceded that the EFC's power to seize the plant was futile without the cooperation of the company's executives (though they asserted that the executives would have cooperated, had push come to shove).⁶¹⁵ Jackson, enraged by what he considered Black's naiveté, responded in private with an anecdote: "I have sat in when the President himself was considering taking over plants under the strongest kind of necessity, and I know that the theory that the Government is not under terrific pressure to come to the best terms it can get is mere academic nonsense."⁶¹⁶

Frankfurter, as the only voting member of the Court to have served in a wartime administration, defied Black on this point.⁶¹⁷ "Of course the Government had the power to take over Bethlehem's shipyards," Frankfurter admitted, "[b]ut the United States was at war. It needed ships—and it needed them at once. The shipyards and plants of a recalcitrant shipbuilder would not produce the necessary tonnage, at least not in the needed time . . ."⁶¹⁸ Congress and the agencies involved knew their constraints better than did the Court. Using this fact, Frankfurter turned the tables on Black and accused him of judicial activism for not taking the political branches at their word when they judged that they lacked the capacity to act more aggressively: "[W]hen these contracts were made, none of the parties believed that there was open to the Government the feasible alternative which now, twenty-five years later, this Court says was open to it."⁶¹⁹ Frankfurter attested that Black, by using the enforcement of the contract to try to make Congress change its policy, was overstepping judicial bounds. The choice of how to meet wartime needs, whether by public enterprise, private contracts, or

that "[i]f the negotiations do not establish duress, the Government finds it in the circumstances themselves." *Id.* at 303.

614. Nye Comm. Report, *supra* note 61, at 46.

615. Brief for Respondents 61, *Bethlehem*, 315 U.S. 289 (Nos. 8 & 9).

616. Letter from Justice Robert H. Jackson to Justice William O. Douglas, *supra* note 22.

617. During World War I, Frankfurter served on the board that negotiated labor disputes. LIVA BAKER, FELIX FRANKFURTER 58–84 (1969). Meanwhile, Byrnes was in Congress. Biographical Directory of the United States Congress, available at www.senate.gov. The four other future Justices were all in the Army or training for it. See WILLIAM O. DOUGLAS, GO EAST, YOUNG MAN: THE EARLY YEARS 91–93 (1974); HOWARD, *supra* note 399, at 14–15 (on Murphy); NEWMAN, *supra* note 592, at 48–49 (on Black); Richard P. Hedlund, *Reed, Stanley Forman*, in 18 AMERICAN NATIONAL BIOGRAPHY 278, 278 (John A. Garratay & Mark C. Carnes eds., 1999).

618. *Bethlehem*, 315 U.S. at 314 (Frankfurter, J., dissenting).

619. *Id.* at 315.

some other means, was a question "of policy for the wisdom and responsibility of the Congress and the Executive. The very limited scope of inquiry to which a litigation on a particular transaction is confined is hardly the basis for judgment on such far-flung issues."⁶²⁰

With respect to the choice of optimal procurement methods, Frankfurter was surely correct. However, if courts were to find duress, they would have to set prices, and in war procurement, that task entailed equally "far-flung" questions. As discussed above, the Justice Department went outside the judicial comfort zone when it asked the Court to make a general inquiry into whether Bethlehem's profit was justified on the basis of efficiency and risk, not merely to judge the profit against a yardstick of fair market value. Specifically, the Justice Department argued that Bethlehem's failure to reduce cost or assume risk meant it deserved no more profit than under a plain CPFF contract. On such a contract, said the brief, the customary profit by the "practice in the market place" in World War I had been about ten percent on cost.⁶²¹ To support this contention, the attorneys cited some anecdotal evidence, including Schwab's decision to reduce another contractor's profit to that level; certain Navy policies, never adopted by the EFC; and some unrelated EFC contracts with Bethlehem.⁶²² One might reasonably criticize these citations as too scattered to establish market norms. Black's response, however, was not so measured or logical. Hell-bent on denouncing war profits, he went outside the record to cite willy-nilly numerous wartime profit figures from various industries that exceeded Bethlehem's twenty-two percent figure, paying no attention to how the contracts compared to the one at issue in terms of cost reduction, investment incentives, or assumption of risk.⁶²³ On the basis of this mindless fact-gathering, he declared that while Bethlehem's profit was "high" and might "justly arouse indignation," it was "not grossly in excess of the standard established by common practice in the field in which Congress authorized the making of these contracts."⁶²⁴

Frankfurter justly castigated Black for selecting examples without reference to efficiency, investment, or risk.⁶²⁵ However, in addition to refuting Black's pseudo-analysis, Frankfurter also cast doubt (perhaps unintentionally) on the capacity of *any* judge to set prices competently. The case record, Frankfurter admitted, shed "little light" on wartime contracting norms, and if one went outside the record, the evidence became "confusing and unreliable," since no mere string of examples

620. *Id.* at 337.

621. Govt. S. Ct. Br., *supra* note 220, at 75.

622. *Id.* at 54-57.

623. *Bethlehem*, 315 U.S. at 306-07.

624. *Id.* at 305 ("high"; "not grossly . . ."), 308 ("justly arouse indignation").

625. *Id.* at 332 (Frankfurter, J., dissenting).

gathered by a judge could possibly "tell the whole story of Government contracts in the last war."⁶²⁶ In other words, a court had neither the specialized personnel nor the investigative resources to undertake the kind of industry-wide analysis that an agency could. Plus, this was only one among several reasons to doubt courts' proficiency in this area. There were also the delays and expense of judicial process, not to mention the reluctance of judges to promulgate prospective rules, especially numerical ones. Although Frankfurter's hard-nosed assessment of the government's wartime necessity created a compelling case for re-pricing of some kind, he failed to answer the objection that courts, lacking the institutional competence for the task, might do more harm than good.

V. THE DECISION AND ITS AFTERMATH

As the moment of decision approached, Black had Murphy, Douglas, Byrnes, and Reed firmly behind him, making for a 5-1 majority. On February 9, 1942, the Justices walked toward the courtroom to announce the opinions. Suddenly, however, Douglas revealed that he was going to dissent, still rejecting the duress theory but accepting the *Burke & James* argument that the savings clause required separate consideration.⁶²⁷ Douglas' embrace of such a logically flimsy argument seems to indicate his discomfort with the substantive outcome of Black's decision. Murphy, too, was uncomfortable. When Douglas' last-minute announcement rendered the majority one vote slimmer, Murphy asked Stone to postpone the decision so that he could write a concurrence distancing himself from Black's rhetoric. Bethlehem's profit, "no matter how it [was] dolled up," agonized Murphy privately, was "inordinate."⁶²⁸ He "want[ed] to condemn it."⁶²⁹ Black's statement that profits like Bethlehem's were "common during the last war," wrote Murphy in his concurrence, "provides no justification . . . for such a practice then or now."⁶³⁰ Still, Murphy agreed with Black that the government possessed "an actual and a potential arsenal of powers adequate to protect its interests in dealings with private persons," so there was no duress.⁶³¹ Thus, only three Justices joined Black's opinion without reservation when the Court finally handed it down on February 16.

Needless to say, the *Bethlehem* decision did not result in the

626. *Id.* at 332-33.

627. *Id.* at 341-42 (Douglas, J., dissenting); JOSEPH P. LASH, FROM THE DIARIES OF FELIX FRANKFURTER 330 (1974) (describing Douglas' last-minute decision).

628. HOWARD, *supra* note 399, at 279 (citation omitted).

629. *Id.* (citation omitted).

630. *Bethlehem*, 315 U.S. at 310 (Murphy, J., concurring).

631. *Id.* at 311.

realization of Black's quixotic quest for public enterprise.⁶³² Nor, however, did it guarantee the ordinary common law security of wartime contracts, as at least one commentator prematurely declared.⁶³³ The United States' declaration of war, combined with new profit scandals, weakened the pro-business political climate that had motivated Jackson to press the litigation back in 1940-1941. Six weeks after the decision, Congressman Francis H. Case, a Republican from South Dakota, proclaimed to his colleagues that, in light of the *Bethlehem* ruling, "we must lock the barn before the horse is taken."⁶³⁴ Accordingly, he introduced a bill to limit profits on all defense contracts to six percent on cost. Though re-pricing after performance had obvious merit, Case's set percentage limit would have tied the hands of the armed services in their efforts to reward efficiency. In response, the chief of Army procurement persuaded Congress to institute re-pricing after performance but with discretion granted to the services to award profits of varying percentages so as to encourage efficiency and fulfill other goals. Congress accepted this solution and enshrined it in the Renegotiation Act.⁶³⁵

And what about the millions of dollars that the Supreme Court ordered the government to pay to Bethlehem? Years earlier, before leaving the Justice Department, Jackson had instructed his colleagues never to pay the judgment, "even if the courts ultimately affirm the decision."⁶³⁶ For its part, Bethlehem did not appear eager to collect, for it was already reaping huge amounts from World War II contracts. In fact, the firm voluntarily returned some of the millions it was making.⁶³⁷ As for the judgment itself, Jackson had his way. The government never paid.⁶³⁸

632. Higgs, *supra* note 21, at 173 (stating that a takeover of the munitions industry was never taken seriously during rearmament for World War II).

633. Kennedy, *supra* note 23, at 164-65; see also *Bethlehem*, 315 U.S. at 312 (Murphy, J., concurring) ("The possibility that the Government may be relieved of bargains twenty-four years after agreeing to them is not conducive to mutual trust and confidence between citizens and their government.").

634. 88 CONG. REC. 3137 (1942).

635. For a full treatment of the Act's passage and later amendments, see SMITH, *supra* note 25, at 351-57.

636. Jackson, *supra* note 257, at 998.

637. Editorial, *The High Cost of Battleships*, NEW REPUBLIC, Feb. 2, 1942, at 135.

638. Letter from Leo A. Lilly, Clerk, to Willard L. Hart, Clerk of the U.S. Court of Claims (Nov. 9, 1954) (*Bethlehem* Case File, National Archives—Mid-Atlantic Region, Philadelphia, PA).
